

PUBLIC HEARING
STATE OF CALIFORNIA
DEPARTMENT OF FOOD AND AGRICULTURE
DAIRY MARKETING BRANCH

DEPARTMENT OF FOOD AND AGRICULTURE
1220 N STREET
AUDITORIUM
SACRAMENTO, CALIFORNIA

THURSDAY, OCTOBER 11, 2007

8:05 A.M.

JAMES F. PETERS, CSR, RPR
CERTIFIED SHORTHAND REPORTER
LICENSE NUMBER 10063

PETERS SHORTHAND REPORTING CORPORATION (916) 362-2345

APPEARANCES

HEARING OFFICER

Ms. Kelly Loyer, Staff Counsel

PANEL MEMBERS

Mr. Hyrum Doegey, Senior Agricultural Economist

Ms. Candace Gates, Research Manager II

Mr. Tom Gossard, Agriculture Economist

Mr. David Ikari, Chief, Dairy Marketing Branch

Mr. John Lee, Chief, Milk Pooling Branch

Ms. Venetta Reed, Supervising Auditor I

Mr. Don Shippelhouse, Milk Pooling Research Manager

ALSO PRESENT

Mr. Rien Doornenbal

Mr. Greg Dryer, Saputo Cheese

Ms. Charlene Franco, Sierra Cheese Manufacturing Company

Mr. Phillip Franco, Sierra Cheese Manufacturing Company

Ms. Sharon Hale, Crystal Cream and Butter Company

Mr. Scott Hofferber, Farmdale Creamery

Ms. Linda Lopes, California Dairywomen's Association

Ms. Barbara Martin, Tony Martin Dairy

Mr. Mike McCully, Kraft Foods

Mr. Joe Mendoza

Mr. Baird Rumiano, Rumiano Cheese Company

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APPEARANCES CONTINUED

ALSO PRESENT

Mr. Michael Shotts, Farmdale Creamery

Mr. Ray Souza

Ms. Sue Taylor, Leprino Foods Company

Mr. William C. Van Dam, Alliance of Western Milk Producers

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1 PROCEEDINGS

2 HEARING OFFICER LOYER: Good morning. This
3 hearing will now come to order.

4 The California Department of Food and Agriculture
5 has called public hearing at the Department's auditorium,
6 1220 N Street, Sacramento, California, on this day,
7 Thursday, October 11th, beginning at 8 a.m. This hearing
8 is the continuation of yesterday's hearing on Wednesday,
9 October 10th.

10 My name is Kelly Loyer. I've been designated as
11 the hearing officer for today's proceedings. I am a
12 disinterested neutral party here and here for the purposes
13 of facilitating the proceedings only. All decisions shall
14 be made by the Hearing Panel. I am not a member of the
15 Hearing Panel and will not be taking part in discussions
16 relative to the hearing.

17 If you have not done so, please turn off your
18 cell phones or set them to vibrate. And we will go ahead
19 and commence with the public testimony.

20 If you testify, again you'll be testifying from
21 that chair right over there.

22 And the first person I will call will be Sharon
23 Hale.

24 The testimony of Sharon Hale will be marked
25 Exhibit 63.

1 (Thereupon the above-referenced document
2 was marked as Exhibit 63.)

3 HEARING OFFICER LOYER: Good morning, Ms. Hale.

4 MS. HALE: Good morning.

5 HEARING OFFICER LOYER: Would you please state
6 and spell your full name for the record.

7 MS. HALE: It's Sharon Hale H-a-l-e.

8 (Thereupon Ms. Hale was sworn by the
9 Hearing Officer to tell the truth and
10 nothing but the truth.)

11 HEARING OFFICER LOYER: And are you testifying
12 today on behalf of an organization?

13 MS. HALE: Yes, I am. It's Crystal Cream and
14 Butter Company.

15 HEARING OFFICER LOYER: Okay. Would you please
16 state your affiliation with that organization.

17 MS. HALE: I am the Vice President, Dairy Policy
18 and Procurement for that organization. My testimony, I
19 prepared and had it approved by the President, Mike
20 Newell.

21 HEARING OFFICER LOYER: Thank you. You may go
22 ahead and proceed with your testimony.

23 MS. HALE: Ms. Hearing Officer and members of the
24 Panel. I'm Sharon Hale, Vice President, Dairy Policy and
25 Procurement for Crystal Cream and Butter Company in

1 Sacramento and have come to the hearing to describe our
2 summary. We believe our milk handling experiences of the
3 past few months are reflective of the overall supply and
4 demand imbalance in California that was made far worse by
5 the unpredictable rise in dry whey prices and the
6 subsequent financial crisis those prices created for many
7 of the state's cheese makers.

8 We appreciate the opportunity to tell our story
9 and will begin by way of some background on our company.

10 As a processor, Crystal has undergone significant
11 change over the past 18 months. Our old plant in downtown
12 Sacramento was closed just over a year ago, leaving only
13 the newer fluid processing and distribution facility
14 across town. However, as a distributor, we remain
15 unchanged in offering a full line of dairy products to
16 customers throughout northern California. The difference
17 is the amount co-packed product we bring through our
18 warehouse and the lack of self-sufficiency relative to
19 balancing our independent milk supply.

20 Not to be ignored but actually not disrupted to
21 our overall business model was the sale of the company by
22 the Hansen family to H.P. Hood, L.L.C., of Massachusetts
23 in May.

24 I don't actually know when Crystal began serving
25 milk to schools but it would be safe to say well over 70

1 years ago. No doubt it began with local schools at first,
2 then expanding along with our footprint. A larger
3 geographic area and increased population have combined to
4 make school milk a noticeable part of our business. This
5 business, while notoriously low margin, is also very
6 competitive, as the ability to place one's label in front
7 of budding consumers on a daily basis seems irresistible
8 from a marketing perspective. In the aggregate, it's also
9 a respectable amount of volume for a processor that can
10 accommodate the distribution challenges.

11 But servicing schools also comes with a
12 significant downside that seems only to worsen with each
13 passing year. I'm referring to school holiday and
14 vacation periods. During these times the entire volume
15 must be diverted to alternative uses. Some might assume
16 the volume simply shifts to home consumption but that has
17 not been our experience. In fact, as schools close for
18 the summer and families head out on vacation, we've come
19 to expect fluid grocery sales to drop off as well. It's
20 the placement of Crystal's school milk volume that we
21 intend to discuss.

22 Under normal circumstances, every week in milk
23 procurement begins with the plant forecasting milk
24 requirements for the upcoming week. Thursday morning,
25 before 10 a.m., I need a milk order. If it matches the

1 volume of milk we expect from our independent producers,
2 no additional steps are required. If it's less or more, I
3 begin contacting a list of likely sources for milk or
4 space, depending on the need. On a good week, the first
5 contact says "yes" and by Thursday afternoon the "who" is
6 known and just the details of written confirmations,
7 routes, times, and receiving schedules remain.

8 We headed into summer knowing that milk in
9 California was going to be long and plant capacity tight.
10 Rising producer prices would either drive outright growth,
11 or at the very least encourage milk to stay in the system.

12 The heat wave in July of '06 had disrupted cattle
13 breeding cycles, causing an unusually high number of cows
14 to freshen just as schools let out for the summer. At
15 Crystal, we were feeling a bit more comfortable knowing
16 that we had come into balance, not buying or selling, in
17 late May following the sale of two dairies with whom we
18 had contracts and were expecting to lose additional milk
19 due to planned dairy farm departures in June and early
20 July.

21 Of the 12.9 million gallons of milk produced in
22 California each day, Crystal's school business utilizes
23 approximately 18,000 gallons of that total. This past
24 summer, 2,226 loads of milk moved off farms on an average
25 day and we needed to find homes for 3. With an

1 independent milk supply, the best alternative to your own
2 plan is one that the milk hauler can reach without
3 disrupting farm pickup schedules; and we're fortunate to
4 have several large manufacturing plants who fit that
5 criteria. In early June we were successful in placing
6 milk in local plants. By late June the options were
7 changing as fresh cows were reaching their peak and high
8 temperatures, which would dampen the supply, failed to
9 appear. Plant managers were increasingly nervous about
10 their own supplies and did not want to push beyond their
11 own capabilities. We felt fortunate if homes could be
12 secured before the weekend for the following week.

13 As a processor, Crystal's not guaranteed the
14 minimum price when we sell milk, nor do we necessarily
15 expect to receive it when milk is long. We appreciate
16 that someone has invested in manufacturing facilities and
17 if their costs are not covered by the manufacturing
18 allowance, offsetting some of the added costs of handling
19 our milk is understandable. In late June, discounts from
20 25 cents to a dollar per hundredweight began to appear.

21 By July, placing excess milk was becoming a full
22 time job and costing more money as the state's milk prices
23 continued to reach record highs. Milk production remained
24 strong and no one nor thing, worker or equipment, got a
25 break.

1 My expectation of placing a week's worth of milk
2 before the weekend was ancient history and I was happy to
3 get something secured through Monday. Some weeks plant
4 managers -- some weeks plant management was told to do the
5 best they could. That meant full silos, aging milk, and
6 offloading delays as 72 hour silo wash deadlines were
7 reached. It was in this month we learned firsthand that
8 the state's pricing for Class 4b had reached critical mass
9 for many the of cheese makers.

10 As the full impact of unprecedented high dry whey
11 prices was being assimilated by cheese makers statewide,
12 we contacted a cheese company that had been very helpful
13 to us in the past. The haul was far from ideal but likely
14 achievable. While very apologetic, we were turned away,
15 not for lack of capacity but because they had no whey
16 processing capabilities and had already made the decision
17 to scale back rather than to incur unrecoverable costs in
18 excess of \$3 per hundredweight resulting from the Class 4b
19 pricing formula. This loss of capacity was only
20 exacerbated by those cheese makers who tried to mitigate
21 the financial impacts of the 4b formula by seeking
22 alternative processing for their own milk, thus becoming a
23 competitor of ours for the remaining processing space.

24 Stories of milk being dumped had circulated for
25 much of the summer and it appeared it would become a

1 reality for Crystal as we prepared the "hit the wall" over
2 the weekend in late July. We had already connected with
3 someone willing to bring our milk into a California
4 location and, in turn, move their milk, located closer, to
5 a plant out of state. When the California plant suffered
6 a breakdown, the only available space was located out of
7 state, and finding tanker trucks to make the trip had thus
8 far been unsuccessful.

9 One of the many consequences of this supply
10 situation was the lack of available tankers. "Available"
11 is the operative word here because as plants filled to
12 capacity, tankers became known as rolling silos as they
13 lined up around plants waiting to offload. We heard the
14 stories of 10, 20 or more sitting full of milk unable to
15 return to dairies to pick up the next route. The
16 long-haul fleet was totally in motion moving milk out of
17 state at both ends for processing.

18 Due to the dedication of the few people trying
19 very hard to avoid the loss of milk and money, a hauling
20 plan was finally scratched together and our own milk
21 joined a caravan already leaving the state for processing.
22 That trip, around \$2700 her load, plus another \$1100 in
23 discounts, seemed huge. But compared to a milk value of
24 \$10,000, there was little else to do.

25 Until the third week of August when enough

1 schools had opened to use all of our milk in filling the
2 pipeline, handling milk remained a daily struggle to find
3 space, locate transportation, keep up with paperwork, and
4 settle with each handler in an accurate manner. For
5 Crystal, the battle's over until the next big holiday
6 comes around. All tolled, our summer milk -- our summer
7 involved the placement of 152 loads of milk at an average
8 cost of a dollar sixty per hundredweight for additional
9 hauling charges and any discounts or fees charged by those
10 that handled the milk. More than one-quarter of that
11 volume -- of the total volume had to leave the state to be
12 processed. This experience certainly puts school business
13 in a different light.

14 Interestingly enough, the incoming volume from
15 our current producers is exactly the same this week as it
16 was the last week of May and we have less producers under
17 contract. Unlike 2006, Crystal did not hold our producers
18 to contractual levels but verbally discouraged growth.

19 But with record high prices for the past several
20 months coming on the heels of a long period of low prices,
21 it's not difficult to understand why dairy farmers have
22 responded and are continuing to respond to these pricing
23 signals with increased production. Considering the many
24 unknowns in the dairy business, passing up the opportunity
25 to put something away for a rainy day would be a tough

1 decision to make.

2 But the consequences of production without
3 adequate processing capacity are the chaotic conditions we
4 have seen over this past summer. In calling this hearing,
5 the Department now has both the opportunity and the
6 obligation to dull the price stimulation and encourage
7 plant capacity within the state.

8 Based on the number of petitioners and those
9 filing alternative petitions, it would appear there is
10 universal support for change as a result of this hearing.
11 The question is what that change might be as we have been
12 presented with several choices. As a member of the Dairy
13 Institute of California, Crystal supports the proposal and
14 testimony given earlier by Dr. Schiek. It addresses both
15 the supply/plant capacity imbalance currently facing
16 California and also alleviates the problems associated
17 with including the dry whey factor in the class 4b pricing
18 formula.

19 Most of the proposals rely on the Department's
20 recently updated weighted average manufacturing costs for
21 butter, nonfat dry milk, cheddar cheese, and dry whey
22 powder. Although these surveys cover the calendar year of
23 2006, they represent the most recent available cost data
24 and should be incorporated into the appropriate class
25 pricing formulas as proposed by the Dairy Institute as a

1 result of this hearing.

2 This step, taken many times in the past by the
3 Department, will both send a pricing signal to producers
4 to slow down production, as well as afford plants the
5 ability to recover some or perhaps all of their cost of
6 converting raw milk into saleable products. In addition,
7 an increase in the manufacturing allowances will also
8 provide the basis for consumers to see some benefit from
9 the abundance of milk as the price adjustments work their
10 way through to the retail level.

11 While no one could have anticipated the
12 tremendous run-up in dry whey prices, the impact of these
13 prices as an inclusion in the 4b formula has been
14 devastating to some of our cheese makers and should be
15 addressed. Producer groups are certain to oppose the
16 removal of the dry whey factor. And from a theoretical
17 perspective, we agree; a product-oriented pricing system
18 should encompass all of the components of milk.

19 But we have yet to hear of an equitable way to
20 account for the variety of methods the cheese makers
21 employ in handling their whey stream. And until such time
22 a method is found, we feel it's more appropriate to remove
23 the dry whey factor from the Class 4b formula.

24 We applaud those who have recognized the impact
25 of the current 4b formula on the smaller operations and

1 submitted proposals to ease their burden. But by design,
2 the proposals provide a lower cost for a measured amount
3 of milk, thus institutionalizing unequal raw product costs
4 for handlers who may will be competitors.

5 Crafting the state's pricing system to
6 differentiate between handlers based on size runs counter
7 to the Department's charge to endeavor to achieve equal
8 raw product costs for handlers operating in the same
9 marketing area. This same issue applies to the proposal
10 to create a two-tiered pricing formula for Class 4b
11 products. That proposal brings the added complication of
12 altering the relationship between Class 4a and Class 2 and
13 3 prices due to the nature of the existing Class 2 and 3
14 pricing formulas. Sourcing ingredients for 2 and 3 --
15 Class 2 and 3 products from different Class 4a
16 manufacturers could yield different raw product costs
17 attributable solely to the two-tiered Class 4a formula.

18 The plant capacity credit proposal is appreciated
19 because its focus is on new capacity within the state as a
20 means of avoiding or, at minimum, improving conditions
21 similar to what we experienced this past summer in placing
22 excess milk. Credits are not limited by the size of
23 capacity, which is a plus. But based on the number of
24 questions at the pre-hearing workshop, there are still
25 some serious equity issues surrounding this concept.

1 Sadly, it's my experience that there are those who play by
2 the rules and there are those who play with the rules. I
3 don't believe it would be long before the Department would
4 find itself with the naughty problem of trying to sort out
5 who should get a credit for what. We wouldn't advise the
6 Department to place itself in that situation at this time.

7 In closing, we feel the evidence quite adequate
8 for the Department to adopt the proposal of the Dairy
9 institute and urge the Secretary to do so as a result of
10 this hearing.

11 That concludes my written testimony. I would
12 like to request the opportunity to file a post-hearing
13 brief.

14 HEARING OFFICER LOYER: That request is granted.

15 Are there questions from the Panel?

16 AGRICULTURAL ECONOMIST GOSSARD: Ms. Hale, on
17 page 3 of your testimony, third paragraph, you cited a
18 cost of dollars per load, 2700, 1100, 10,000.

19 MS. HALE: Right.

20 AGRICULTURAL ECONOMIST GOSSARD: What assumption
21 did you make about the size of the load in either gallons
22 or pounds?

23 MS. HALE: Oh, those are average 50,000 pound
24 loads.

25 AGRICULTURAL ECONOMIST GOSSARD: Fifty thousand

1 pound?

2 MS. HALE: Uh-huh.

3 AGRICULTURAL ECONOMIST GOSSARD: Thank you.

4 No further questions.

5 DAIRY MARKETING BRANCH CHIEF IKARI: Thank you
6 for your testimony. I just have a couple of questions to
7 ask you.

8 The surplus milk that Crystal has, do you
9 normally try to ship that or sell that -- market that to
10 cheese plants?

11 MS. HALE: Not necessarily. As I indicated,
12 there are several large plants that are located fairly
13 close to us. And two of those are in fact butter powder
14 plants and one is a cheese plant. So our first telephone
15 calls have always gone to those -- somewhere amongst those
16 three plants.

17 DAIRY MARKETING BRANCH CHIEF IKARI: The response
18 from the butter powder plants, were they just simply full?

19 MS. HALE: They were simply full. They indicated
20 that -- in one case they had been taking some of our spot
21 milk like through the Easter time and whatnot. And they
22 had made some other arrangements that filled their space.
23 The other, simply their own milk totally filled them.

24 DAIRY MARKETING BRANCH CHIEF IKARI: I'm kind of
25 interested in perhaps a little more detail. You had some

1 of it in your testimony.

2 If the state doesn't have adequate processing
3 capacity, why is it that you feel that the 4b -- you
4 mentioned 4b in the whey -- why is that the problem or the
5 issue --

6 MS. HALE: That's --

7 DAIRY MARKETING BRANCH CHIEF IKARI: -- versus
8 4a?

9 MS. HALE: Well, that's not the total issue,
10 because obviously I started with, you know, our concern is
11 the overall supply and demand. And I think the Dairy
12 Institute proposal does address that in partiality because
13 the proposal to change the make allowance both on the
14 powder and on the cheese side. The cheese side is
15 particularly noted because of the impact of the dry whey.
16 And so that's why that got a little more mention. But
17 both need to be adjusted so that the plants that are in
18 California that can in fact process excess milk have the
19 capability to do so and aren't precluded because of the
20 lack of the manufacturing allowance.

21 DAIRY MARKETING BRANCH CHIEF IKARI: IF status
22 quo should result from this hearing, what would you
23 predict or expect or project for Crystal as we go into the
24 next season?

25 MS. HALE: The next season is Thanksgiving. And

1 basically its Thanksgiving, it's Christmas, it's Easter,
2 it's summer. Those are all the time periods. And all of
3 the contacts that I have -- that I made during the summer
4 and that I still keep tabs on because I'm curious as to
5 what they think's going to be happening, all of them give
6 me the same response and, that is, we're in trouble. The
7 state is in trouble in capacity. And this is going to be
8 a very bad year if something doesn't change.

9 And in the short run, I'm not sure you're going
10 to fix thanksgiving.

11 DAIRY MARKETING BRANCH CHIEF IKARI: I guess I'm
12 asking the question: Is it going to be worse than what
13 you had -- will, you know, 2008 be worse than what you
14 experienced in 2007? Do you see that happening?

15 MS. HALE: Well, for Crystal's perspective, we're
16 trying to, yeah, change our milk supply that would improve
17 our own situation. And that is done simply by, you know,
18 having more departures. And we do have a couple of
19 dairies that have given us an indication that, yeah,
20 they're selling and getting out of the business.

21 And so we have sort of a fall-back plan for
22 ourselves individually. But with the closure of the --
23 announced closure of DFA's Corona cheese plant and with
24 the issues that were brought up yesterday, the different
25 cheese handlers that have gone on the ineligible list, I

1 think we have the potential for a worse situation than we
2 had in the summer.

3 DAIRY MARKETING BRANCH CHIEF IKARI: Am I correct
4 in assuming then by you saying we've got to handle our
5 production, that you're talking about limiting or reducing
6 the amount of milk that you're going to receive in the
7 upcoming year?

8 MS. HALE: Right. From Crystal's perspective,
9 the way that -- you know, with our own milk, we don't have
10 to have a hundred percent of our own milk. We can reduce
11 that number and then we can buy in some of this milk
12 that's on the market. So we can buy supplemental milk
13 very simply and very easily in this market. And so we
14 could -- we can adjust our own independent supply.

15 DAIRY MARKETING BRANCH CHIEF IKARI: You're in
16 communication with other fluid processing plants. Is your
17 experience -- do you find that your experience is similar
18 or are there -- what are the other processors that you
19 talk to -- are they -- with respect to the same thing that
20 you've testified?

21 MS. HALE: Well, most of the other fluid
22 processors don't necessarily have their own milk supply.
23 We are unique in that we have our own milk supply, but we
24 have -- and it is in large part a hundred percent of our
25 supply, and we closed our balancing. You know, one of the

1 close nearby fluid handlers, they have a large butter
2 powder plant. One of the others, they have a little bit
3 of their own milk, but they get -- by far and away, the
4 bulk of their milk comes from a cooperative who has to
5 balance for them.

6 So I'm not sure that anybody else is exactly in
7 our position.

8 DAIRY MARKETING BRANCH CHIEF IKARI: Well, I just
9 wondered if whether or not they've indicated to you that
10 their supply and co-op is having problems taking that --
11 balancing the milk?

12 MS. HALE: In large part, because these are
13 competitors of ours, that's not exactly -- there's a lot
14 of discussions we do not have with our competitors --

15 DAIRY MARKETING BRANCH CHIEF IKARI: Okay.

16 MS. HALE: -- that's sort of along those lines.

17 DAIRY MARKETING BRANCH CHIEF IKARI: Thank you.

18 HEARING OFFICER LOYER: Are there any further
19 questions from the Panel?

20 Thank you, Ms. Hale.

21 MS. HALE: Thank you.

22 HEARING OFFICER LOYER: Next I'd like to call
23 Mike McCully.

24 Mr. McCully's testimony will have been marked
25 Exhibit 64.

1 (Thereupon the above-referenced document
2 was marked as Exhibit 64.)

3 HEARING OFFICER LOYER: Good morning, sir.

4 MR. McCULLY: Good morning.

5 HEARING OFFICER LOYER: Would you please state
6 and spell your full name for the record.

7 MR. McCULLY: My name is Mike McCully
8 M-c-C-u-l-l-y.

9 (Thereupon Mr. McCully was sworn by the
10 Hearing Officer to tell the truth and
11 nothing but the truth.)

12 HEARING OFFICER LOYER: Are you testifying today
13 on behalf of an organization?

14 MR. McCULLY: On behalf of Kraft Foods.

15 HEARING OFFICER LOYER: Please state your
16 affiliation for the record.

17 MR. McCULLY: My position with Kraft is Associate
18 Director of Dairy Procurement.

19 HEARING OFFICER LOYER: Okay. And please
20 identify the process by which the organization, Kraft,
21 finalized your testimony today.

22 MR. McCULLY: The testimony was developed by
23 myself and reviewed with several other folks within the
24 Dairy Procurement Group as well as our State and Corporate
25 Government Affairs Department and our Legal Department.

1 HEARING OFFICER LOYER: Thank you.

2 MR. McCULLY: It's typical as we do both state
3 and federal order testimony.

4 HEARING OFFICER LOYER: Okay. Thank you.
5 You may proceed.

6 MR. McCULLY: Thank you.
7 Good morning.

8 Ms. Hearing Officer and members of the Hearing
9 Panel. My name is Mike McCully. I'm Associate Director
10 of Dairy Procurement at Kraft Foods in Glenview, Illinois,
11 with responsibilities for U.S. milk procurement in
12 addition to U.S. and global dairy market analysis and
13 dairy commodity risk management.

14 Kraft currently operates a multi-product dairy
15 plant in Tulare, California. This plant produces
16 primarily parmesan and other Italian cheeses along with
17 dry whey powder. With the closure of Kraft's Visalia
18 facility earlier this year, the production of cottage
19 cheese and sour cream was moved to Tulare.

20 In addition, Kraft purchases cheese and other
21 dairy ingredients from several companies located in
22 California. Consistent with prior testimony on this
23 subject, we support the proposal from F&A Dairy, et al.,
24 to remove the whey factor from the 4b formula.
25 Additionally, as a member of the Dairy Institute of

1 California, we support their alternate proposal.

2 There are several tenets of a regulated pricing
3 system that are not being met in California. First, a
4 regulated pricing system is intended to create orderly
5 marketing conditions. When milk is regularly being
6 transported out of state due to inadequate processing
7 capacity in California, or is being dumped on the farm, it
8 is clear orderly marketing conditions do not exist. This
9 is even more evident when one considers dairy commodity
10 prices are at or near record high levels. Another tenet
11 is that the system establishes a regulated price which
12 allows the market to clear. Milk production in California
13 continues to grow while in-state processing capacity has
14 not kept up with this growth. Given the current
15 conditions in California, changes need to be made to the
16 regulated pricing system in order for the California dairy
17 industry to continue to grow.

18 Milk supplies. California milk production
19 continues to grow consistent with longer-term trends. In
20 2007, the state's milk production is up 4.7 percent versus
21 year ago through August. This compares to the ten-year
22 trend from 1997 to 2006 of plus 4.2 percent. In absolute
23 numbers, the growth over this ten-year period is in excess
24 of 11 billion pounds of milk, over 1.1 billion pounds of
25 additional milk each year. And to put these numbers into

1 perspective, this annual growth represents over 3 million
2 pounds of milk each day or over 60 truckloads.

3 Manufacturing capacity. To accommodate this milk
4 supply growth each year, it is imperative for the
5 continued success of the California dairy industry that
6 the state fosters and builds additional manufacturing
7 capacity. In order to handle the growth in milk supplies
8 noted above, we estimate the State of California will need
9 one new cheese plant per year or another type of
10 manufacturing facility such as butter powder or milk
11 protein concentrate.

12 Before 2003, cheese manufacturing capacity in
13 California had grown steadily. However, since then cheese
14 plants have been expanded or built in other states, while
15 California has seen little to no expansion.

16 The April 2006 Dairy Foods magazine listed 41
17 projects in the U.S. for dairy plant construction or
18 expansion that have been recently completed, are underway,
19 or in the planning stages. Only 3 of those 41 projects
20 are in the State of California, with one additional one
21 being the recent expansion project of Leprino's Lemoore
22 West plant.

23 It has become evident the State of California is
24 not the preferred location for building a cheese or dairy
25 plant. And not only are new plants not being built;

1 existing ones are closing. We closed the butter powder
2 operation into Visalia in January of 2007. DFA has scaled
3 back cheese production in Corona and will close the
4 operation late this year. So while a few new plants will
5 add manufacturing capacity, those gains are being offset
6 by other plants closing.

7 Until the last few years California's regulated
8 pricing environment encouraged dairy industry growth and
9 provided an advantage over other areas of the country.
10 Now that advantage is gone and other areas are taking
11 market share from California.

12 Without significant new investment in plant
13 capacity, the California dairy industry will find it
14 increasingly difficult to handle the growth of milk
15 supplies. At the June 2006 hearing, I noted reports of
16 milk moving out of the state and being dumped on farms.
17 Reviewing the weekly USDA Dairy Market News fluid milk and
18 cream reports for 2007 -- and those are attached as
19 Appendix 1 -- it appears the situation continues and has
20 likely worsened. Since the beginning of the year, the
21 weekly reports mentioned problems handling milk within the
22 State of California 60 percent of the time, or 24 out of
23 40 weeks. Additionally, 50 percent of the time, or 20
24 weeks, there was mention of milk or components moving to
25 other states for processing.

1 There are significant volumes of milk moving out
2 of the state, either as raw milk or UF milk, into
3 manufacturing plants in the northwest, southwest, and even
4 midwest. While not widely reported, there have also been
5 incidences of milk being dumped on the farm, most recently
6 as late September. These types of conditions might be
7 expected if there was a milk surplus and commodity prices
8 were low. Instead, these conditions are occurring when
9 both domestic and global market prices are at or near
10 record high levels. A logical conclusion of this
11 situation is the state has inadequate capacity to process
12 growing milk supplies into products demanded by the
13 marketplace.

14 If California's dairy industry is to remain
15 competitive in a domestic as well as a growing global
16 market, it is imperative that the regulated pricing system
17 foster, not impede, the development of new processing
18 capacity.

19 Whey issues. The addition of a whey factor to
20 the 4b price formula has been a long and -- has a long and
21 contentious history. The problem is complex but the
22 solution is simple: Remove the whey component from the 4b
23 price formula.

24 Before 2003, whey was not included in the price
25 formula for 4b milk. In early 2003, in a period of low

1 milk prices, the whey factor was added to the formula,
2 breaking from longstanding Department position on this
3 issue. The Hearing Panel report noted, quote, "For years
4 the Department has made policy decisions not to include an
5 explicit pricing component for whey in the Class 4b
6 formula. Based on testimony and relevant data, this
7 position has been reaffirmed at each of the hearings that
8 have been open to recommendations for including a whey
9 pricing component," end quote. Since it was added,
10 numerous problems have arisen. The hearings in 2005 and
11 2006 went into detail on the whey manufacturing allowance,
12 CDFA's manufacturing cost survey data, and other whey
13 issues. At each hearing the Panel's recommendation was
14 the same: Remove the whey component from the 4b formula.

15 The hearing Panel's report from February 2005
16 detailed the problem.

17 "As was reported in the January 2003 hearing
18 determinations, the incorporation of a pricing component
19 to the 4b formula" -- "to the 4b pricing formula reflect
20 the value that cheese operations earn from their skim whey
21 stream, or the residual of cheese production, has not been
22 easy or straightforward. The skim whey stream has
23 historically been a waste byproduct of the cheese making
24 process. As the cheese industry has matured and
25 environmental regulations have become more stringent, the

1 development of whey byproducts have become more
2 commonplace by necessity. Still the investments required
3 to process skim whey stream into value-added products are
4 significant and the financial risks for processing the
5 whey stream into a value-added product are considerable."

6 The Panel's recommendation was to remove the whey
7 factor in the 4b pricing formula and was concisely
8 summarized as follows:

9 "The Panel is mindful of using a manageable
10 pricing formula. It seems clear from the positions taken
11 by producer/processor witnesses that incorporating a
12 factor for the value of the whey stream appears to be
13 intractable. Given the testimony and evidence before the
14 Panel, it would be far wiser to simply remove the skim
15 whey factor from the Class B pricing formula than to
16 continue to expand this factor in an inconsistent manner
17 with the butter and nonfat dry milk and cheddar cheese
18 pricing formulas."

19 But like Bill Murray's character in the movie
20 Groundhog Day, the problem of the whey component was back
21 again at the June 2006 hearing. And once again the
22 Panel's recommendation was to remove the whey factor from
23 the formula for the same reasoning as the prior hearing.

24 "As the result of reviewing the testimony and for
25 reasons outlined above, the Panel continues to support the

1 removal of the whey factor in the 4b pricing formula as it
2 did in the 2005 hearing determinations."

3 Proposals have also been made regarding the
4 addition of WPC or other whey proteins into formula.
5 Unlike cheese, butter, and nonfat dry milk, there is not
6 one standard whey product that is appropriate to use in
7 pricing formulas. The Panel's report from both 2005 and
8 2006 hearings detailed this problem.

9 "Whey is one of the biggest reservoirs of food
10 protein and can be made into a wide variety of both food
11 and non-food products. In the food category, it can be
12 used in baby food, diet supplements, bakery products,
13 salad dressing, beverages, and confections. It can be
14 made into pharmaceutical products, yeast products, and
15 industrial products. Unlike cheddar cheese, butter, and
16 nonfat dry milk, which have defined standards of identity
17 and fairly uniform processes, each of these whey usages
18 require their own unique processing equipment, processing
19 procedures, with vastly different associated costs. While
20 economies of scales are critical in successful whey
21 operations, the Panel is mindful that an inappropriate
22 decision on this factor can inadvertently make the
23 previously profitable whey enterprise a losing proposition
24 should it overstimulate the production of a particular
25 whey product."

1 An editorial by John Umhoefer from the Wisconsin
2 Cheese Makers Association in the August 3rd, 2007, Cheese
3 Market News, I attached as Appendix 2 -- I believe it was
4 also introduced yesterday -- provides additional
5 documentation of the problem of attempting to value the
6 whey stream.

7 Of the 90 plants that replied to the WCMA survey,
8 91 percent did not produce dry whey. About 42 percent of
9 the plants performed minimal processing and received
10 minimal payment for their product. Those plants that sold
11 wet, skimmed whey earned 10 to 20 cents per pound in June
12 2007, compared to the NASS price of 72 cents a pound for
13 dry whey powder. Most of the remaining plants -- there
14 were 42 of them -- performed various combinations of
15 ultrafiltration, reverse osmosis, and/or evaporation to
16 separate whey components and condensed whey.

17 It is evident that the addition of the whey
18 component to the 4b price formula has introduced a
19 multitude of problems and needs to be removed. This is
20 true not only in the California pricing system, but also
21 in the Federal Order system. An unintended consequence
22 has been the financial strain on cheese plants following
23 the unprecedented increase in dry whey prices over the
24 past year. F&A Dairy and other's proposal is to eliminate
25 the whey component from the formula. Prior hearing panels

1 have come to the same conclusion.

2 Alternate proposals. I appreciate the
3 recognition by producers of the problems the whey
4 component is having on the state's cheese making industry.
5 However, their proposals to alleviate the problems fall
6 short, and I will briefly address each.

7 We do not support any portion of the proposal
8 from the Alliance, Western United, and Milk Producers
9 Council. The three parts include a whey credit for the
10 first 100,000 pounds of milk each day, adjusts the whey
11 manufacturing allowance to the nonfat dry milk cost plus 3
12 cents, and snubs the whey value at the manufacturing
13 allowance. While the whey credit would help a handful of
14 small plants, it ignores the impact the whey component is
15 having on plants of all sizes. Basing the manufacturing
16 allowance off the nonfat dry milk allowance has been
17 discredited in past hearings. And snubbers are poor
18 policy tools that have been rejected in the past.

19 At a time when new manufacturing capacity is
20 needed in the state, a proposal that would increase the 4b
21 price by 48 cents will not attract new plant investment.

22 We support Land O'Lakes' proposal to update the
23 make allowances for butter, cheese, and nonfat dry milk,
24 but do not agree with the method of calculating the whey
25 manufacturing allowance. We do echo their comment that

1 they are, quote, very concerned about the apparent lack of
2 manufacturing capacity in California, and we believe it's
3 absolutely essential to make changes in the Class 4a and
4 4b formulas to encourage development of additional
5 manufacturing capacity in California, end quote.

6 We do not support CDI's proposals. Their
7 proposal to use their own plant data rather than CDFA's
8 audited manufacturing cost data seems counter to the use
9 of manufacturing cost survey data in regulated pricing
10 systems. We feel this has the potential to open up a new
11 can of worms in future hearings. And while CDI's plant
12 processing credit is interesting, the lack of details
13 prohibits much in-depth discussion.

14 The proposal from Humboldt to create a
15 multi-tiered pricing would add another layer of regulation
16 to milk pricing. In effect, processors of different sizes
17 would have different milk costs which breaks from the
18 statute of equal raw product costs. Asides from being
19 more complicated to administer, it also would restrict
20 growth. If a plant just under the lower tier maximum
21 wanted to expand, their reward for expanding would be
22 higher milk costs. Obviously, this would be a
23 disincentive for future growth. This and other proposals
24 move in the direction of more government regulation and
25 away from more free-market oriented policies we at Kraft

1 have long supported. Therefore, we oppose them.

2 Price impacts. I also appreciate the fact the
3 Hearing Panel and the Department is put in a difficult
4 place when regulating milk prices. A decision that lowers
5 the milk price is never popular with dairy farmers no
6 matter whether the price is \$10 a hundredweight or \$20 a
7 hundredweight. For this hearing, CDFA calculated the
8 impact of removing the whey component from the formula
9 would have lowered the 4b price by 24 cents a
10 hundredweight and the quota and overbase prices by 14
11 cents a hundredweight in the September 2002 through August
12 2007 time period.

13 While producer witnesses will likely detail the
14 significance of those impacts of dairy farmers, it
15 highlights the difficulty in trying to regulate the
16 minimum prices. By definition, a minimum regulated price
17 should be set so the market clears. If there is
18 additional revenue generated from the milk, then it be
19 returned in the form of premiums, cooperative earnings, or
20 other payments.

21 Another important factor overlooked by the
22 producers is the losses their cooperatives sustain in
23 either plant operations or additional milk hauling costs.
24 These costs are reblended back to farmers by the
25 farmer-owned cooperatives, so they have already realized

1 the losses, except they just weren't apparent on the milk
2 check.

3 Several cooperatives have either closed, as DFA's
4 Golden plant, or sold, like Land O'Lakes cheese plants, in
5 the last year. In news of the closing of DFA's Golden
6 Cheese Company, the plant controller noted, quote, "milk
7 prices have risen so sharply in recent months that those
8 costs alone are more than the factory can get from selling
9 cheese," end quote. And when milk was hauled out of
10 state, those additional trucking costs are passed back to
11 farmers. Therefore, it is important to consider these
12 facts when establishing minimum regulated prices.

13 Time for a change. While the regulated pricing
14 system in California served the industry well for years,
15 it is becoming more apparent that it's time for a change.
16 Regulated pricing systems in California and the Federal
17 Orders were established many years ago with vastly
18 different market dynamics than exist today. The dairy
19 markets have evolved from local to regional to national to
20 global in nature. Dairy farmers, through the California
21 Milk Advisory Board, commissioned a study by McKinsey and
22 Company on the future of the California dairy industry. I
23 strongly believe the industry would be better served
24 focusing on long-term solutions rather than attending
25 hearings on pricing formulas.

1 McKinsey offered several detailed options on how
2 to move forward, and I'd encourage the dairy producer
3 leaders to explore them.

4 I believe the U.S. dairy industry has the
5 potential to fill the growing world demand for dairy
6 products. With 95 percent of the world's food consumers
7 outside the U.S., the potential market is enormous.
8 Unfortunately, outdated regulated systems are holding back
9 the U.S. dairy industry from realizing the full potential
10 of this opportunity. Other countries will eventually grab
11 it if we do not.

12 The time for a change is now. Kraft has long
13 believed in transitioning to a free-market environment and
14 feel the U.S. dairy industry would benefit greatly from
15 this change. A great way to start that change would be
16 with the removal of the dry whey factor from the 4b
17 formula.

18 Summary. In summary, I would like to encourage
19 the Department to adopt F&A Dairy, et al's proposal as
20 well as alternate proposal from Dairy Institute. They
21 best address the needs of California's dairy industry and
22 positions the entire industry, both processors and --
23 producers and processor, for future growth.

24 I thank you for the opportunity to testify here
25 today. And I would like to file a post-hearing if

1 necessary.

2 I welcome any questions at this time.

3 HEARING OFFICER LOYER: Your request to file a
4 post-hearing brief is granted.

5 Are there any questions from the panel?

6 MR. McCULLY: I will note real quickly, the
7 appendix I attached as A is -- as I noted earlier, is from
8 the weekly U.S. Dairy Market News. This is by week,
9 foldout comments directly from the Dairy Market News from
10 their fluid milk and cream situation reports on California
11 as well as surrounding states to give an idea of both milk
12 production and the milk disposition in these areas.

13 AGRICULTURAL ECONOMIST GOSSARD: On page 2 of
14 your testimony at the top under "Manufacturing capacity,"
15 you mention three plant projects for California and then
16 an additional one, making four, the Leprino.

17 Do you recall what the other three plant
18 expansions or new constructions were?

19 MR. McCULLY: Of the three I remember putting in
20 last year, one is the Visalia plant of CDI's, which was
21 the major one. The other two were smaller. And I want
22 to -- it's going to tax my memory here. One of them
23 was --

24 AGRICULTURAL ECONOMIST GOSSARD: Post-hearing
25 brief?

1 MR. McCULLY: Yeah, I'd like to do that. That
2 would be best.

3 AGRICULTURAL ECONOMIST GOSSARD: Sorry. I didn't
4 mean to stretch you that far.

5 MR. McCULLY: It's early in the morning.

6 AGRICULTURAL ECONOMIST GOSSARD: More coffee.

7 The other thing, in the second paragraph on that
8 page you refer to the appendix and that 24 out of 40 weeks
9 and 50 percent of the time certain things happen. Now,
10 you note that 2006 was similar. I realize there's going
11 to be a lot of work on your part. But could you go back
12 to 2005 for the same period and get a sense for how often
13 there was mention of components moving out of state or
14 problems handling milk? I mean you've documented it well,
15 but we need a baseline for comparison.

16 MR. McCULLY: That's a good question. I'll look
17 into that too.

18 AGRICULTURAL ECONOMIST GOSSARD: Thank you.

19 MILK POOLING BRANCH CHIEF LEE: Mr. McCully, I do
20 have one question.

21 What's caused the closure of your plant in
22 Visalia?

23 MR. McCULLY: It was a combination of things. As
24 probably most of you recall, the plant is a -- probably
25 older plant would be the best way to characterize it. It

1 was the old Knudsen plant that we bought back in the late
2 eighties, I believe.

3 The Tulare facility of ours has -- at that time
4 had a lot of extra room in it, so it was just making the
5 parmesan, some of the Italian style cheeses. As Kraft
6 overall was rationalizing plant capacity across all the
7 different products, the Visalia plant for the culture
8 product production we have the ability -- or had the
9 ability to move that production over into the Tulare
10 plant, which had the room. But at the time, you know,
11 safe to assume the butter powder operation is not wildly
12 profitable, so that decision was made to close that at the
13 first of the year. And then the spring and early summer
14 had the culture product production moved over to the
15 Tulare plant.

16 MILK POOLING BRANCH CHIEF LEE: Thank you

17 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: On
18 page 4 of your testimony, you make reference to plants
19 selling wet, skimmed whey at 10 to 20 cents per pound in
20 June compared to the NASS price of 72 cents a pound for
21 dry whey powder.

22 The 10 to 20 cents, is that per pound of solids
23 in that wet whey or is that the solids and the fluid
24 carry, or water, if you will, or the wet price?

25 MR. McCULLY: I'd have to -- I could put that in

1 a post-hearing brief. I'd have to go back to the survey
2 and see exactly how that was defined. I don't recall off
3 the top of my head.

4 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE:

5 Okay. Thank you.

6 HEARING OFFICER LOYER: Are there any further
7 questions from the panel?

8 Thank you, Mr. McCully.

9 MR. McCULLY: Thank you.

10 HEARING OFFICER LOYER: Next I'd like to call
11 Bill Van Dam.

12 Mr. Van Dam's testimony is marked Exhibit 65.

13 (Thereupon the above-referenced document
14 was marked as Exhibit 65.)

15 HEARING OFFICER LOYER: Good morning, sir.

16 MR. VAN DAM: Good morning.

17 HEARING OFFICER LOYER: Would you please state
18 and spell your full name for the record.

19 MR. VAN DAM: My name is William C. Van Dam. Van
20 Dam is spelled capital V-a-n capital D-a-m.

21 (Thereupon Mr. Van Dam was sworn by the
22 Hearing Officer to tell the truth and
23 nothing but the truth.)

24 HEARING OFFICER LOYER: And are testifying today
25 on behalf of an organization?

1 MR. VAN DAM: Yes, I am. The organization is the
2 Alliance of Western Milk Producers.

3 HEARING OFFICER LOYER: And would you please
4 state your affiliation for the record.

5 MR. VAN DAM: I am the CEO.

6 HEARING OFFICER LOYER: Okay. And please
7 identify the process by which the organization finalized
8 your testimony today.

9 MR. VAN DAM: The concepts -- all the concepts
10 included in this testimony were approved by the board of
11 directors of the organization at our September 24th
12 meeting.

13 HEARING OFFICER LOYER: Thank you. You may
14 proceed with your testimony.

15 MR. VAN DAM: Thank you.

16 Ms. Hearing officer and members of the Hearing
17 Panel. My name is Bill Van Dam and I'm here today
18 representing the Alliance of Western Milk Producers, of
19 which I am Chief Executive Officer.

20 The Alliance is an association of cooperatives
21 that has as its members California Dairies, Inc. (CDI),
22 Dairy Farmers of America - Western Council (DFA), and the
23 Humboldt Creamery Association. The California members of
24 these three organizations produce a bit more than 63
25 percent of the milk produced in this state.

1 The concepts presented in this testimony today
2 were approved by the Board of Directors at their meeting
3 on September 24th. We're grateful for the opportunity to
4 present evidence with regard to the matters before this
5 hearing.

6 First subheading, "Whey has value."

7 The original petitioners have asked that the whey
8 component value be dropped from the Class 4b formula. In
9 making this request, they are implying that whey has no
10 value. What they really mean, I suspect, is that whey has
11 so little net value that it should not be shared with
12 producers via the Class 4b formula. We could not disagree
13 more.

14 Exhibit A, which is attached to this testimony --
15 in Exhibit A I have calculated the value of the whey
16 portion of the 4b formula from its inception in April of
17 2003 until now and have made some educated guesses based
18 on futures markets to fill in the blanks until the end of
19 this year.

20 The total value of the whey component paid to
21 producers in that time period is just slightly in excess
22 of \$600 million.

23 Diverting from the text a little bit. It's just
24 amazing to me how big this industry has become in
25 California. It's a lot of value in these things.

1 To me, that is a stunning total that clearly
2 illustrates that whey does indeed value in the formula.
3 But we must stress that this is a number that is the
4 residual value of the whey after the make allowance has
5 been deducted from the formula. Over the same period of
6 time the total make allowance left in the hands of the
7 cheese processors, an astounding \$1 billion. That is the
8 total of the make allowances that were allowed applied to
9 the volumes as they're calculating them.

10 A full 62 percent of the total value of the whey
11 component as valued by the price of dry whey stayed with
12 the processor. The residual amount, 38 percent, was
13 included in the 4b price.

14 We are also mindful of the fact that dry whey is
15 nearly always the lowest value product that is made from
16 the whey stream and indeed is actually made in only a few
17 plants in this state. The fact that over 80 percent of
18 the whey that is processed in this state is converted into
19 more sophisticated products is a clear indication that dry
20 whey is the least profitable choice. My point here is
21 that the formula as presently constructed does not
22 unfairly allocate whey value to producers at the expense
23 of processors.

24 The highly unusual and unprecedented run up in
25 the dry whey prices which began shortly after the hearing

1 on these matters in June of 2006, and continued for nine
2 consecutive months until it peaked in May of 2007, pushed
3 the total annual value of the whey component in 2007 to
4 over \$300 million. That number works out to \$160,000 per
5 average producer in this state.

6 At the opposite end of the spectrum is the
7 experience of 2003 when whey pricing was first introduced
8 in the formula. The first five months were negative and
9 in total caused a reduction in the Class 4b price of \$9
10 million. But by year-end the market had recovered a bit
11 to close at a negative \$4 million.

12 In 2004, the contribution was \$49 million. In
13 2005 it was \$105 million. In 2006 it was \$135 million.
14 As noted above, the year 2007 total will exceed \$300
15 million.

16 The world demand for milk proteins is strong.
17 The world market prices this year seem to have already set
18 their highs for whey products and nonfat dry milk, but
19 there continues to be sufficient demand for all the
20 product now being produced in the world and at prices that
21 in any other era would have been considered excellent.

22 There are strong signals that dry whey prices
23 have recently floored at 39 1/2 cents per pound. Futures
24 markets have had a nice bounce in price. And more
25 importantly, volumes sold and contracted have risen

1 dramatically.

2 Based on the futures market for dry whey which
3 shows expected prices of between 43 and 44 cents through
4 September of next year, it seems probable that the whey
5 component value will be about \$180 million next year,
6 about 33 percent higher than 2005 but a little over half
7 of last year's value. Therefore, if the whey component
8 were removed from the 4b formula next year, the average
9 California producer would have \$100,000 less annual
10 income.

11 Without the whey value in the 4b price, the
12 California Class 4b price in May 2007 would have been
13 another \$3.11 per hundredweight less than the
14 California -- than the Federal Order Class 3 price. That
15 would be \$18.48 per hundredweight in the Federal Order,
16 while the price for cheese milk in California would have
17 been \$14.94.

18 In that same month the whey component made up a
19 full 17 percent of the Class 4b prices shown in Exhibit B,
20 page 2.

21 Given the magnitude of these numbers and the
22 important percentage of the Class 4b price that is
23 generated by the whey component both in this state and in
24 the Federal Order, we believe that it is impossible to
25 argue that the whey component has no value. Indeed,

1 likewise, we believe it is impossible to argue that the
2 value is so insignificant that it should not be shared
3 with producers.

4 While we certainly agree that some adjustments to
5 the formula may be necessary, we firmly believe that this
6 is not a broken valuation system that needs to be thrown
7 out. To the contrary, the formula has worked quite while
8 during its lifetime.

9 Whey, indeed, does have value and sometimes, like
10 earlier this year, it has a lot of value.

11 The lead petitioner for this hearing is F&A
12 Cheese of Newman, a midsize plant that produces dry whey.
13 The most serious problem with our whey valuation system of
14 last year was that the dry whey prices rose to unheard of
15 levels and pushed the whey component values to levels that
16 were difficult to recover from the whey protein
17 concentrate prices.

18 This imbalance in values has corrected itself now
19 and the dry whey prices once again make sense compared to
20 WPC and nonfat dry milk prices. But F&A was producing the
21 product that is the basis of our pricing system and we're
22 in a position to recover the full value from the market.
23 Whey prices peaked in May of this year.

24 The petition for this hearing was dated August
25 14th, during a period when dry whey prices were falling

1 rapidly. And I know from personal experience that this
2 next statement is true. It is never pleasant to be the
3 marketer of a commodity product in a falling market. But
4 that is a reality of being in these markets. And it is a
5 reality unrelated to the existence of it in the Class 4b
6 formula.

7 The real issue. In the Panel findings of the
8 2006 hearing that also considered Class 4b prices, the
9 Panel comments that including the value of the skim whey
10 stream has not been -- has not been, it should be -- has
11 not been easy or straightforward. We agree with that
12 statement. But just because it is hard to do is not a
13 reason to not do it.

14 The panel recommendation for both 2005 and 2006
15 hearings was to remove the whey factor from the Class 4b
16 formula. We believe that it is because of this stated
17 view that the petitioners for this hearing have called for
18 the removal of the whey component. The value of whey has
19 clearly become so substantial that absent the repeated
20 suggestion by the Panel that the whey value be removed
21 from the 4b formula, the current petition would have been
22 dismissed as outrageous.

23 It is this belief that there is a chance that the
24 whey component for the 4b formula will be removed that
25 keeps a full and honest discussion from occurring within

1 California -- within the California dairy industry about
2 how to better determine the value of the whey stream. So
3 long as those who know the most about the process of
4 making whey products and who also know the most about how
5 those products are priced refuse to participate fully in
6 the process of establishing a formula, there will be
7 discontent among all parties to the regulated system.

8 The value of the whey products is too large to
9 ignore. And the new face of world trade is such that whey
10 proteins will continue to be in demand and will command
11 prices higher than what we've had in the past. It is time
12 to recognize that economic reality and to accept that the
13 issue is not how to get rid of the whey component but how
14 to properly value the whey stream. To reasonably
15 accomplish that goal we need to have the cooperation of
16 all segments of our industry.

17 We urge the panel to drop its suggestion that the
18 whey value be deleted and replace it with an unequivocal
19 statement that whey has value and that it properly belongs
20 in the Class 4b formula. That statement would then focus
21 attention on the determination of a fair and reasonable
22 formula.

23 The small plant issue. At our request CDFA has
24 prepared a table that groups all 60 of the cheese plants
25 in California -- and then in parens -- that report monthly

1 to the pool by size. This table is very revealing and
2 shows a surprising number of small plants in the state.
3 Twenty-one of the plants process less than 250,000 pounds
4 of milk a month. A total of 35 plants process less than 3
5 million pounds of milk a month. As has been noted
6 frequently by the Panel in earlier findings, the capital
7 cost of whey processing facilities is very high.

8 As a practical matter, plants that process under
9 a hundred thousand pounds of milk a day simply cannot
10 economically justify investments in whey processing. They
11 must find other ways to clear their whey volumes. Yet,
12 these plants, as you all know, must pay the full class 4b
13 price for their milk while being unable to recover any of
14 the value from the marketplace. These are typically
15 specialty cheese plants. And prior to 2006 this added
16 milk cost was absorbed by the small plants. It appears
17 they were able to incorporate their added cost into their
18 cheese prices. The run up in prices beginning in 2006 and
19 into 2007 however added more cost more quickly than ever
20 before and placed these operators in financial stress.
21 With the prospect of higher values continuing into the
22 future, these plants will continue to face these same
23 pressures, albeit at lower levels than last year.

24 Whey credit. This is the beginning of testimony
25 in support of the joint petition.

1 In response to this issue the Alliance of Western
2 Milk Producers, Milk Producers Counsel, and Western United
3 Dairymen are jointly proposing a whey credit system for
4 these smaller plants. We settled on the idea of a credit
5 for specific plants in order to provide a benefit to those
6 who need it. It would be impossible to adjust the Class
7 4b price without having nearly all the benefit go to those
8 who are already recovering the full value from the whey
9 stream.

10 Another alternative would be a second Class 4b
11 price that would apply a certain volume of milk at each
12 plant. But this would cause some legal questions because
13 the creation of what would appear to be a new class, 4b
14 prime perhaps, that would be the cause of constant
15 confusion in terms of product pricing and reporting.

16 California has a long history with credits in its
17 milk pricing system. Transportation credits,
18 transportation allowances, and fortification allowances
19 each have provided examples of how to address the issue of
20 credits within the system.

21 Carefully designed credits that are properly
22 justified have served our industry well in the past and we
23 believe that our suggested credits meet that test.

24 There are three elements to our proposal. But
25 the critical part is the credit itself. We are proposing

1 that each plant be allowed a credit equal to the whey
2 component value of the 4b formula each month for the first
3 100,000 pounds of milk processed into cheese per day, or
4 roughly 3 million pounds per month. All plants get this
5 credit, no matter what their size, to avoid those
6 questions of discrimination that a hard cutoff would
7 cause. It is proposed to apply the credit to the pounds
8 of Class B solids not fat processed each month. Only
9 those who are pool plants or purchase their milk from pool
10 plants will be eligible for this credit.

11 It is proposed that the credit will be issued as
12 a credit to pool obligations of pooled plants, or
13 cooperatives, and that the credit would be passed through
14 the pool source to the plant that earned the credit.

15 The result of applying this credit is that 35 of
16 the 60 plants would get all of their milk without paying
17 any part of the whey component portion of the Class 4b
18 formula. These plants are valued customers of milk and in
19 total process meaningful volumes of milk, and obviously
20 they have the potential to grow. But perhaps of equal
21 importance, they add image and pizzazz to our industry.

22 However, it is critical to note and to understand
23 the impact of this proposal on the next level of plants.
24 First consider the next size group of six plants that
25 average 233,000 pounds of milk processed per day. The

1 effect of our proposal is to create an incentive for these
2 plants to invest in whey processing equipment because they
3 would be able to keep the proceeds from the first 100,000
4 pounds of milk per day as additional benefit to their
5 project.

6 On the average they would get the whey for no
7 cost on 43 percent of their volume. If the projections
8 indicated by the futures market are correct at 43 cents
9 per pound, these plants would have an extra \$28,500 per
10 month to justify their whey plant investments. This is
11 money available in addition to the make allowance which is
12 available on the entire volume processed. This amount of
13 added monthly income would support interest payments on an
14 investment of over 4.5 million if money were available at
15 7.5 percent.

16 On all other categories the math works the same.
17 The credit would in every case provide significant
18 incentives that could be invested in new and additional
19 whey processing.

20 Exhibit C attached to this testimony is a
21 modified version of the grouping of plants prepared by
22 CDFA for this hearing. I have not changed the base
23 numbers shown in the first seven columns, but have added
24 columns which are used to calculate the impact of the whey
25 credit.

1 There are three versions of the exhibit. The
2 first, C-1, represents expected values for 2008 and the
3 credit is based upon the 43 cent dry whey price. All
4 three versions use the current formula with the current
5 make allowance. Obviously it's snubbed. It won't count
6 on that because we're not anticipating that being applied
7 next year.

8 I will explain Exhibit C-1 in some detail, and
9 then briefly discuss the next two. Under the title, top
10 center, is the basic variable data for these tables. The
11 first is the pounds of credits allowed per day. And the
12 second is the estimated value of the whey contribution per
13 hundredweight of 4b milk.

14 On Exhibit C-1 the value is set using the dry
15 whey price of 43 cents that is suggested by the futures
16 market which generates a value of 95 cents per
17 hundredweight.

18 The second column from the right edge outlined in
19 the dark box is the calculation of the percentage of milk
20 in that group that is eligible for the credit. Note that
21 all milk in the first five groups is eligible for the
22 credit.

23 The next group down is the 3 million to 10
24 million pounds per month group. But only 43 percent of
25 this milk will be eligible for the credit. In the biggest

1 group, that's the biggest plants, the credit will only
2 cover 2 percent of the volume.

3 The right-hand column is the total credits per
4 day for all plants in each group. Note that the total in
5 daily credits to all plants is \$28,757. From this -- and
6 that's daily, that's the daily credit. This we calculate
7 is \$874,221 in total monthly credits given with this set
8 of data assumptions.

9 It is helpful to point out that this set of data,
10 the total value of the whey component, is just over \$15
11 million.

12 Exhibit C-2 is the same calculation, with the
13 whey contribution of \$2.78 per hundredweight, which is the
14 average of the five highest months in 2007, that's March
15 through July, and generates an average credit -- average
16 monthly credit of \$2.5 million. And I stress, that is
17 money that producers are offering to give up if those
18 situations ever happen again to help those who have to
19 face the issue.

20 The total average whey component value in each of
21 these month is over 44 million.

22 The last table in this group, Exhibit C-3, is set
23 at 30 cents per hundredweight, which is the average whey
24 component value from April 2003 through November of 2005.
25 And I chose those months because November 2005 is when the

1 prices started to move upwards. So I'm catching the
2 period before, a fairly long period. At this rate the
3 total credit would be 276,000 per month.

4 I have used these three ranges to give some sense
5 of the range of possibilities for this credit.

6 In all three cases the size of the credit is 6
7 percent of the total volume, because the entire credit is
8 based upon the fixed volume of a hundred thousand pounds
9 maximum per plant.

10 The intention of our whey credit system is to
11 focus substantial value on those who need it most, the
12 smallest plants who cannot recover the value, and to
13 create an incentive for the next bracket of plants to
14 invest in whey processing facilities.

15 I should add here that there's no requirement
16 that that's what they do with the money. Nonetheless that
17 is a logical extension of what the idea is here.

18 The snubber. The second part of our proposal is
19 to snub the whey component value of the 4b formula so that
20 it does not go below zero.

21 I've got seven seconds.

22 AGRICULTURAL ECONOMIST GOSSARD: Three, two --

23 MR. VAN DAM: What do I do now? Do I go re-sign
24 up or --

25 HEARING OFFICER LOYER: Try and wrap it up

1 quickly.

2 MR. VAN DAM: It won't take long.

3 HEARING OFFICER LOYER: All right. Then go
4 ahead.

5 MR. VAN DAM: Two more minutes.

6 The second part of our proposal is to snub the
7 whey component value of the 4b formula so that it does not
8 go below zero. The practical issue is that it would allow
9 the whey component to become a negative number. The
10 operation of a mathematical formula will cause the credit
11 to become a charge to those eligible for the credit. The
12 charge would bring the 4b price back to the price that it
13 would have been without the whey component portion. But I
14 believe that that is a confusion factor that would be
15 difficult to deal with and explain in an ongoing basis.
16 All would work more smoothly if it were agreed that the
17 whey component factor would not go below zero.

18 Our enthusiasm for a snubber would be muted
19 somewhat if we felt that the make allowance factor for dry
20 whey came closer to being a rational estimate of the cost
21 of making the whey. Ms. LaMendola in her testimony had an
22 excellent presentation of the various considerations for
23 establishing a more rational make allowance. It makes no
24 sense to us to have a whey component go negative in a
25 formula at a price that is in reality quite -- still quite

1 profitable to the plant.

2 Last one, make allowance. The third part of our
3 proposal is to set the make allowance used in determining
4 the whey component value of the 4b formula at the make
5 allowance for nonfat dry milk plus 3 cents.

6 Again I refer to the testimony of Ms. LaMendola,
7 who has covered this issue in detail. Barring the
8 construction of a new dry whey plant in California, which
9 is certainly not impossible if our proposed credit system
10 is put in place and some of the midsize plants take
11 advantage of the available funds to build a new facility,
12 there will only be two dry whey plants supplying data to
13 CDFA. If this happens, a new idea needs to be applied.
14 We could live with the make allowance determined from the
15 Cornell study but note reluctance on the part of CDFA to
16 use data from outside the state. Therefore, we find the
17 use of the California cost studies for nonfat dry milk
18 with an added factor to account for the extra water in
19 whey compared to nonfat dry milk would be a sensible
20 solution.

21 This ends the testimony in support of the joint
22 petition.

23 I can wrap up quickly here.

24 I can tell you we're opposed to removing the whey
25 from the 4b formula.

1 We are in favor of the incentive of plant
2 processing capacity credits. Milk production in this
3 state is growing quite rapidly. We do need more plants.
4 And this is a good idea for trying to focus -- again,
5 focus the money. This industry so huge, if we put -- if
6 we spread everything across everybody, we bring such a
7 huge volume down that the cost is just unbearable.

8 Cost study adjustments to make allowances. We've
9 consistently supported the position that Class 4a make
10 allowances reflect the currently available cost-justified
11 changes and we continue in that position.

12 We have no position on the allowances for smaller
13 plants as proposed by Humboldt Creamery.

14 In closing. It is easy to forget that it was
15 only 14 months ago that the 4b price climbed above \$11 per
16 hundredweight after six full months below that level. For
17 the six months of March through August of 2006, the 4b
18 price averaged \$10.52 per hundredweight. The contribution
19 of whey during that period averaged 61.5 cents per
20 hundredweight. Without the whey in the formula the 4b
21 price for that six-month period would have averaged \$9.91
22 per hundredweight. Producers and processors are both in
23 the milk business for the long term. Pricing systems must
24 consider the long term if they are to be effective and
25 serve the interest of all parties. We cannot allow

1 short-term abnormal situations to drive changes that will
2 in the long term be harmful to our industry. Whey values
3 belong in Class 4b formula and it is our collective task
4 to be sure the method of that inclusion makes sense.

5 That concludes my prepared testimony. I would
6 like to request the right to submit a post-hearing belief.

7 HEARING OFFICER LOYER: That request is granted.

8 Are there questions from the panel?

9 MR. VAN DAM: Seeing none.

10 (Laughter.)

11 AGRICULTURAL ECONOMIST GOSSARD: We're fighting
12 over precedent.

13 On page 7 of your testimony, you have cost study
14 adjustments to make allowances. And you say the Alliance
15 has consistently supported the position that Class 4a make
16 allowances should reflect the currently available
17 cost-justified changes and continues in that position.

18 First of all, does this policy position also
19 apply to Class 4b make allowances?

20 MR. VAN DAM: There is only one fairly small
21 cheese plant within my membership. And the organization
22 has consistently taken the position of not commenting on
23 4b pricing. That is for those who are involved in that
24 business.

25 AGRICULTURAL ECONOMIST GOSSARD: Although doesn't

1 DFA have a little cheese plant as well?

2 MR. VAN DAM: Right now they do, for the moment.
3 There's two -- there are a couple of them. But there's
4 not -- it is not the significant part of what my
5 membership does.

6 AGRICULTURAL ECONOMIST GOSSARD: But just -- so
7 you're not willing to comment on a general policy as
8 regards both setting make allowances in general, but only
9 as they apply to 4a?

10 MR. VAN DAM: Yes, our official position is that
11 we're dealing with 4a. We are avoiding commenting on 4b
12 because that is of much greater interest to other people.
13 Except the obvious extent of the whey pricing. That is a
14 general theoretical issue that we're dealing with there.

15 AGRICULTURAL ECONOMIST GOSSARD: Okay. On page 4
16 you mention a couple of times the hundred thousand pound
17 credit and the possibility of -- with your credit that
18 they might start building drying facilities. But we had
19 testimony yesterday that you have to be processing a
20 million pounds of milk a day before it becomes viable to
21 process dry whey.

22 So does that mean based on that testimony that
23 your credits should start at a million pounds rather than
24 the hundred thousand?

25 MR. VAN DAM: It depends on how you're measuring

1 things. We believe that at a hundred thousand we've
2 created enough incentive for things to start happening and
3 it provides a significant aid.

4 Many have testified that whey processing is a
5 wide array of things that can happen. And there are some
6 more limited things you can do like simply condensing and
7 moving it somewhere else that do not require you to be at
8 a million pounds. A million may be a good number if
9 you're going to do a full scale everything yourself.
10 We're trying to find a way to get these people into a mode
11 where they can participate in that whey value.

12 AGRICULTURAL ECONOMIST GOSSARD: At the bottom of
13 page 4 you say only those who are pool plants or purchase
14 their milk from pooled sources would be eligible for this
15 credit. But the amendment that's being proposed for the
16 state plan just talks about a reduction in the price for
17 4b plants of a certain size. If you're not a pool plant,
18 you're controlled by the state plan. And all the state
19 plan says is price reduction at a certain size.

20 So I'm not quite sure if you're a non-pool plant
21 regulated by the state plan with -- you've written in a
22 lower price, how could they not get the credit?

23 MR. VAN DAM: Well, they're not going to get it
24 from the pool. They're going to have to get it from their
25 own producers if it's right -- I would make a point that

1 Ms. LaMendola made in her testimony. And, that is, we're
2 trying to state our intent as clearly as possible. And we
3 made an attempt to write the language as required by the
4 petition rules. But you gentlemen are the pros at writing
5 this language that will cover the intent. And we've
6 certainly given you the right to do that.

7 Our intent is clear. It's intended that it will
8 only go to pool plants or people that are buying from pool
9 plants -- pooled sources. I don't know how else we would
10 establish the credit.

11 AGRICULTURAL ECONOMIST GOSSARD: Okay. On
12 page --

13 MR. VAN DAM: Excuse me. And you've made the
14 comment, reducing the 4b price. And we're not intending
15 to do that. It is a credit that we want to establish in
16 certain circumstances only.

17 AGRICULTURAL ECONOMIST GOSSARD: What I was
18 commenting on was strictly the state plan. In the state
19 plan it does have a reduction of the 4b price, plain and
20 simple. Does it not?

21 MR. VAN DAM: We don't intend to write it that
22 way. We want to establish the ability to establish a
23 credit.

24 AGRICULTURAL ECONOMIST GOSSARD: Okay. At the
25 top of page 3, you mention the relationship among whey

1 protein concentrate, nonfat dry milk, and dry whey prices.

2 Am I to assume that what you did was take the
3 price for each of those commodities and divide by the
4 protein level in each of those commodities to come up with
5 its relationship?

6 MR. VAN DAM: I don't believe I stated what the
7 relationship was.

8 AGRICULTURAL ECONOMIST GOSSARD: Okay, okay.

9 MR. VAN DAM: All I'm saying there is that we
10 have a complex array of products, and if we put our heads
11 together, we can get them incorporated in a rational
12 formula that will uncover a wider array of things.

13 Oh, that's okay, Tom. I like answering those
14 questions.

15 (Laughter.)

16 AGRICULTURAL ECONOMIST GOSSARD: Well,
17 actually -- well, okay. At the top of page 3, "The most
18 serious problem was our whey valuation system was the dry
19 whey prices rose to unheard of levels and pushed the whey
20 component values to levels that were difficult to recover
21 from the WPC prices. This imbalance in values has
22 corrected itself now and dry whey prices once again make
23 sense compared to WPC and nonfat dry milk prices."

24 That's the issue I've had. How did you make the
25 comparison among the three, you know, commodity prices?

1 MR. VAN DAM: I'm sorry. I'm on topic with you
2 now, Tom.

3 AGRICULTURAL ECONOMIST GOSSARD: Okay.

4 MR. VAN DAM: And the way I made that calculation
5 was simply restated the values that are available to us
6 from the Dairy Market News and restated those as pounds of
7 protein -- take the full value and divide by the pounds of
8 protein to get a protein per pound value. And what
9 happened during that stretch is that the value of the
10 protein in dry whey soared compared to the other products
11 and put them in a spot where they were paying on the basis
12 of something they weren't recovering.

13 AGRICULTURAL ECONOMIST GOSSARD: Do you recall
14 off the top of your head what values you assumed in terms
15 of protein content for each of the three products?

16 MR. VAN DAM: Yes, 13 percent, 34 percent.

17 AGRICULTURAL ECONOMIST GOSSARD: And for nonfat
18 dry milk?

19 MR. VAN DAM: Thirty-five.

20 AGRICULTURAL ECONOMIST GOSSARD: And, finally,
21 you mentioned that it has come back to a more sensible
22 relationship.

23 But if it's happened once, can't it happen again?

24 MR. VAN DAM: Well, it certainly can. That's my
25 point. It's more sensible right now. And I guess the

1 underlying point there is that for the immediate future
2 that same kind of pressure isn't there; but it could
3 happen again, which is why I would encourage that we set
4 this thing up so that everybody in the system is
5 encouraged or incentivized to participate in understanding
6 this and putting the other formula that works in all
7 circumstances.

8 AGRICULTURAL ECONOMIST GOSSARD: Okay. Which
9 goes back to the first answer you gave to my question when
10 I didn't explain -- okay. Thank you. That clarifies it.

11 MR. VAN DAM: Nice circle there, Tom.

12 AGRICULTURAL ECONOMIST GOSSARD: I go around in
13 little circles, yes.

14 HEARING OFFICER LOYER: Are there any further
15 questions from the Panel?

16 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: Yes.

17 Just listening to your answer to Tom's
18 question -- and I had marked that same section -- you
19 indicate that the current -- well, again the most serious
20 problem with the current price structure ended up being
21 the relationship between those two.

22 If there was a mechanism put in place to make
23 sure that in the formula at least the price used was not
24 out of relationship with the other values with the other
25 products, would that help alleviate the serious problem

1 that you refer to?

2 MR. VAN DAM: Oh, it certainly would have. It
3 would have made a substantial difference last year and
4 would have caused much less ruckus than what's happened
5 right now. It was unforeseen. The history of the whole
6 whey pricing thing is that dried whey was the lowest value
7 product. It was the most commodity-like. And, as such,
8 was always -- or typically the lowest. Therefore, that
9 relationship stayed correct and the whey protein
10 concentrate returned more value than did dry whey.

11 Last year that went upside down. And Tom's
12 right, it could happen again, and we should anticipate
13 that and have a system set up that would not -- you have
14 to understand a basic thing here from the producer side of
15 the equations is we do not want to have the system allow
16 people to be backwards on their plants. We want to
17 encourage investment in plants. But we want it to be set
18 up so they know they can make a return on investment and
19 that they aren't going to have upside down formulas.

20 Now, nobody's come up with a solution to the
21 falling market. A falling market is just the reality of
22 being in business totally. But these price imbalances can
23 be dealt with and probably should be. And we would be
24 anxious to attend honest sessions discussing this.

25 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: And

1 in referring to those sessions, you indicated that we
2 could put our heads together and come up with a rational
3 formula.

4 Are you suggesting then what we're using now is
5 not rational?

6 MR. VAN DAM: No, it's rational enough. But when
7 I use the word "rational" -- first of all, we have to have
8 rational formulas. That's just the way it has to be. But
9 I'm not saying ours is so irrational, because it was built
10 on very rational points that sort of got thrown out the
11 window by the events of last year.

12 And also we've got the added thing that the world
13 has changed. It's been fairly dramatic and fairly quick
14 and it looks like it's not going to change from that any
15 time soon. So we're going to be international marketers
16 of product for quite awhile. And we need to understand
17 how that impacts us.

18 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: And
19 in your testimony -- different point -- you question
20 the -- and, I'm sorry, I don't recall exactly where it's
21 at. But you make reference to 4b prime or basically two
22 separate class 4b prices.

23 Doesn't the proposal that you have before us,
24 doesn't it somewhat do the same thing?

25 MR. VAN DAM: We're obviously dealing with the

1 same dollars when you ask that question. We are precisely
2 and directly making the statement we do not want to create
3 two 4b prices. We want to use a credit. And I know it's
4 a fine point of distinction, but it's one worth making.
5 And the credit will be given to -- only to certain people
6 in certain circumstances. Well, they'll all get it, but
7 the real beneficiaries are the very small plants.

8 Reporting two prices just strikes me as being a
9 folly. We would have all kinds of problems dealing with
10 that.

11 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: You
12 make comparisons to your proposed credit to the
13 transportation credit system that we have in place now.
14 That credit is optional. If a handler chose not to apply
15 for that credit, then they wouldn't receive that credit.
16 And what I'm wondering is, you're putting a floor --
17 you're referring to a snubber, I would refer to it as a
18 floor -- on that whey price not to go below the make
19 allowance. And your expressed reason for doing that was
20 so that the handlers -- the small handlers wouldn't have a
21 charge rather than a credit.

22 Could the factor work the way it does today, and
23 simply by not applying for that credit, which is now a
24 charge, couldn't they be protected from not having that
25 credit cost them money?

1 MR. VAN DAM: I believe that that is a clever
2 solution and would also work.

3 I always thought you were going to say that some
4 of the big plants that are offended by our proposal would
5 therefore not apply for it. And I would happy with that
6 too.

7 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE:

8 Well, I'm thinking that the way you have the
9 floor in the formula, even the large plants, if you put
10 that floor in there, then you would be putting a whey
11 price in that is higher than the market price without even
12 consideration for the cost of manufacturing that product.
13 And that's what I'm thinking, if there was a way to
14 address your concern that that computed charge -- or
15 computed credit ended up being a charge, and then try and
16 resolve both of those issues perhaps.

17 MR. VAN DAM: You know, our position is that we
18 would like to see the snubber. But you could also
19 consider, instead of snubbing the whole thing, just snub
20 the formula at zero so it doesn't go to a charge.

21 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: The
22 formula -- when you say the formula, are you --

23 MR. VAN DAM: The credit formula.

24 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: The
25 credit formula.

1 MR. VAN DAM: We're laying an idea out here that
2 we think has merit that attacks an issue. But we also
3 realize that with ideas in front of you, you guys need to
4 make them work out the way that they suit you best.

5 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: And
6 on the substantive issue, what is your opinion regarding
7 whether or not this is a substantive change to the pool
8 plan and whether it would need to go to referendum?

9 MR. VAN DAM: That's a good question. I
10 obviously don't believe that it's substantive enough that
11 it causes a vote. But if it did go to a vote, I'm not
12 worried about the outcome. That's number one.

13 Number 2, if we stay with a hundred thousand
14 pounds that we propose, that's a 6 percent reduction in
15 the volume of money that's in the whey component.
16 Throwing out the whey component is a number massively
17 bigger than that; and if anything substantive, it would be
18 that. So comparatively we go a very unsubstantive issue.

19 I'm not calling for a vote if you do throw it
20 out. Don't get me wrong. But maybe --

21 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: The
22 4b formulas and whether or not the changes in the class
23 price formulas are a substantive change or not, those are
24 subject to a vote. However, any arrangements to the pool
25 plan obviously could be.

1 So I guess one of my other questions then is: If
2 it did go to a vote, wouldn't we be asking producers to
3 vote on a class price change indirectly?

4 MR. VAN DAM: It would be indirect -- I guess
5 that's for the legal heads to look at. It doesn't seem
6 that massive of a change, and we've got wide support for
7 it.

8 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: I
9 have no other questions.

10 DAIRY MARKETING BRANCH CHIEF IKARI: Your
11 organization represents some of the largest suppliers in
12 the state. Is it in the -- and you mentioned, you
13 testified that you're going to comment primarily on the 4a
14 pricing formula.

15 Is it in the long-term interest for the future
16 growth of the California dairy industry to move to butter
17 and powder exclusively?

18 MR. VAN DAM: Well, that's an interesting
19 question. And it is not as clear to answer as it may
20 appear. But looking at the values of product right now,
21 well, it certainly is. Two dollar powder, the returns for
22 4a is substantially better than the returns for 4b right
23 now.

24 If we're right about projections for the future
25 on world trade, being in nonfat dry milk makes a lot of

1 sense. That seems to be the future for here.

2 If you look at the 4b, the cheese plants and
3 what's going on with cheese, and the fact that the new
4 plants are being built between us and the future
5 customers, that market doesn't look as great as it used
6 to.

7 So the pure economics of it would be that we
8 should not be terribly afraid of going toward 4a.

9 DAIRY MARKETING BRANCH CHIEF IKARI: But if you
10 took all California's growth and put it in 4a, you're not
11 worried that you might oversaturate the 4a situation?

12 MR. VAN DAM: Well, the world is a big place and
13 there's billions of mouths out there that are hungry.
14 And -- you know, there is some signs that there might be
15 some cheese trade in the international market also. That
16 has not developed very much yet, but some is moving. It
17 is showing on the reports now that some cheese is moving
18 internationally. So that could be a place we need to go
19 too.

20 But realistically we need to look to the world
21 for our sales of our product.

22 DAIRY MARKETING BRANCH CHIEF IKARI: You
23 indicated that the formulas -- the 4b formulas work quite
24 well.

25 Has it worked well in terms of processing

1 capacity for cheese plants?

2 MR. VAN DAM: Phenomenally well. I mean the
3 amount -- when you deal with these numbers and you see the
4 size of them, the amount of growth that has steadily
5 happened in California in cheese plants has just been
6 astounding. What is it, two billion pounds the last
7 couple of years we produced in California? That is a
8 lot -- that's really a lot of product.

9 But the market is way over on the eastern
10 seaboard. And we've sent our brothers and cousins and
11 nephews and nieces off to Idaho, New Mexico, and Texas to
12 produce milk, and they built plants over there. And our
13 access to those markets is not as good as it used to be.
14 And they -- Idaho's not in the pricing system. Mr. Jeter
15 explained how they avoid participating in the Class 3
16 price in New Mexico -- or maybe in Texas. Maybe he wasn't
17 intending to explain it, but he did talk about depooling
18 and how you could do that.

19 It's going to be tough for us to lower our prices
20 enough to beat them out. We've got to look elsewhere.

21 And if I didn't answer your question, ask it
22 again and I'll --

23 DAIRY MARKETING BRANCH CHIEF IKARI: Well, you
24 did.

25 Since your organization represents some of the

1 largest milk suppliers in the state -- there's been much
2 testimony today and yesterday about plant capacity, milk
3 being shipped outside the state or not being able to
4 handle it.

5 Do you have a different perspective that you can
6 share with the hearing? Or would you confirm what has
7 been discussed or testified to?

8 MR. VAN DAM: Let me answer it this way: Your
9 comment about the cheese plants -- your question before
10 about the cheese plants probably was, Why aren't the
11 cheese plants growing fast enough to absorb all the new
12 growth? And they are growing but they're not growing that
13 fast.

14 DAIRY MARKETING BRANCH CHIEF IKARI: Well, does
15 it concern -- I'd rephrase it to say: Has the formula
16 encouraged the building of new plants in the state -- new
17 cheese plants?

18 MR. VAN DAM: Apparently not, because there are
19 no new ones. What has happened is there's been a quite
20 stunning growth of the existing plants and their
21 capacities.

22 DAIRY MARKETING BRANCH CHIEF IKARI: Right.

23 MR. VAN DAM: It amazed me last year when I did
24 the calculations, because I thought, you know, I was going
25 to see huge growths in the 4a, and we didn't have it last

1 year. And it was because the cheese plants did some
2 expanding. So, yes, there's capacity growth going on
3 there.

4 DAIRY MARKETING BRANCH CHIEF IKARI: But the
5 existing plants and not new plants.

6 MR. VAN DAM: That's the difference -- well,
7 because they've got market limits to it. And those limits
8 aren't all formula related. And I think we've noticed for
9 several years now that if we don't expand into world
10 markets and into products that can be sold
11 internationally, we're going to run into some serious
12 problems here in California.

13 DAIRY MARKETING BRANCH CHIEF IKARI: Then if I
14 take your other comment and put them together, if you
15 think that the future is for butter powder, then the
16 Alliance is not concerned that we do not have plant
17 expansion for 4b in the future?

18 MR. VAN DAM: Certainly not as concerned as
19 others seem to be. 4b will continue to expand. There
20 might be some more plants. A lot of milk's produced in
21 California and the growth trend is pretty steady.

22 DAIRY MARKETING BRANCH CHIEF IKARI: Okay. Now,
23 I was trying to switch to the milk supply and the adequacy
24 of our processing capacity to handle the milk supply. And
25 being a representative of some of the larger silk

1 suppliers, do you have different testimony than what we've
2 taken in at this hearing? Or can you confirm some of the
3 reports? For example, Crystal testified about their
4 difficulty. There's been reports about milk being shipped
5 outside the state.

6 MR. VAN DAM: I have a few details that I even
7 know. I know milk is shipped out of state. I know our
8 capacity constraints are difficult right now. We have a
9 tough time getting everything processed. CDI has built a
10 new plant. It will be on line in a matter of months
11 now -- the Visalia plant. They understand that they're
12 going to have to invest in additional facilities to keep
13 up with the supply out there.

14 It's probably not as complete an answer as you
15 want, but --

16 DAIRY MARKETING BRANCH CHIEF IKARI: Well, I've
17 heard reports, and perhaps you can confirm or deny, that
18 one of your members is shipping milk out of the state and
19 charging the members for those out-of-state shipments. Is
20 that true?

21 MR. VAN DAM: No, it is true. Milk is being
22 shipped out of state. And there's milk being shipped into
23 state too; 75 million pounds last month.

24 DAIRY MARKETING BRANCH CHIEF IKARI: In your past
25 experiences you've operated cheese plants. And in

1 response to Tom's questions you kind of touched on this.
2 About how large a plant do you need to be before it makes
3 economic sense to invest in a full scale dry whey
4 operation?

5 MR. VAN DAM: I can answer that partially from
6 the experience that I had. When I was managing a plant in
7 idaho, we were processing, when I started managing,
8 400,000 pounds of milk a day. We had not a full whey
9 processing set up. We had RO units in UF units. Well, we
10 had UF when I started, then I put RO in. And we shipped
11 that to another plant that processed it into whey protein
12 concentrate. They dried it at another plant. So at that
13 level it was certainly justified to do that. And then the
14 plant of course was growing, and so it was became easier
15 and easier. And eventually after I left they put a drier
16 in also.

17 So you could reach down to some pretty low
18 levels -- we're going to call 400,000 pounds a day low
19 level -- but, anyway, you start getting some economics and
20 doing some processing at levels way below the million
21 pounds per day.

22 I'd probably agree with a million pounds per day
23 being necessary for really a --

24 DAIRY MARKETING BRANCH CHIEF IKARI: -- full
25 scale?

1 MR. VAN DAM: -- full scale. But I am not an
2 expert. Just I've had some experience with it.

3 DAIRY MARKETING BRANCH CHIEF IKARI: I'm
4 intrigued a little bit by your discussion of interest to
5 have an honest session to develop a fair 4b pricing
6 formula. I'd be curious if you could add in your
7 post-hearing brief what conditions you think would be
8 necessary to structure -- where we can bring all the
9 parties together and nobody hangs back, everybody has an
10 interest -- what steps the Department could take to set
11 the stage so that all parties come together and honestly
12 negotiate a fair equitable price.

13 MR. VAN DAM: Okay. I touched on that -- an
14 answer to that in my testimony. And the point I would
15 make in response to that question is that leaving one side
16 or the other completely comfortable with the results of
17 this hearing would never bring them to the table.

18 DAIRY MARKETING BRANCH CHIEF IKARI: So if we
19 make everybody uncomfortable, then we can bring everybody
20 to the table?

21 MR. VAN DAM: You got it.

22 DAIRY MARKETING BRANCH CHIEF IKARI: Okay.

23 MR. VAN DAM: And I'm not saying that
24 facetiously. But if you eliminate the whey from the
25 formula, the other side's not going to come to the table

1 and talk with us. We'll be interested. If you leave it
2 very favorable to the producer side of the interest, or
3 created an even better situation for us, then we might not
4 be quite so interested. But if everybody has a clear
5 understanding that something needs to happen, otherwise
6 we're going to stay with this, that's somewhat
7 uncomfortable to everybody. And then in my post-hearing
8 brief I'll think on that some more and lay out any other
9 ideas I have.

10 DAIRY MARKETING BRANCH CHIEF IKARI: Whatever
11 ideas that you have that you think would structure the
12 best chance for success, I'd be -- we'd appreciate that.

13 MR. VAN DAM: The best chance for success is
14 going to be an honest and full disclosure discussions.
15 That's what it's going to be.

16 DAIRY MARKETING BRANCH CHIEF IKARI: What about a
17 concept of a temporary decision as a result of this
18 hearing? With the knowledge that the Department will
19 review it again -- well, we're going to read this once a
20 year. But perhaps the Department issue a decision for a
21 period of six months or something shorter with the
22 understanding that we're going to come back and review the
23 thing with some -- would that put pressure on all the
24 parties to get together?

25 MR. VAN DAM: I'm going to have to think about

1 that one whether it would, but it probably would. You
2 know, I was going to comment that all decisions are
3 temporary till the next hearing anyway.

4 (Laughter.)

5 MR. VAN DAM: And you might not want to tie your
6 hands too tight. We might move quickly and it might not
7 go so good for a while. But the understandings have to be
8 developed between those parties and the industry. And we
9 can get there, because, you know -- not exactly brimming
10 with ideas, but there's a whole bunch of ideas out there
11 you can come up with on how to approach this.

12 But I certainly don't know enough to say whether
13 they're really going to work or not. And you need to have
14 the participants from the other side participating in
15 that.

16 DAIRY MARKETING BRANCH CHIEF IKARI: Thank you.

17 MR. VAN DAM: You're welcome.

18 HEARING OFFICER LOYER: Are there any further
19 questions from the panel?

20 Okay. Hearing none.

21 Thank you very much for your testimony, Mr. Van
22 Dam.

23 Next I'd like to call Greg Dryer.

24 Mr. Dryer's testimony is marked Exhibit 66.

25 (Thereupon the above-referenced document

1 was marked as Exhibit 66.)

2 HEARING OFFICER LOYER: Good morning, sir.

3 MR. DRYER: Good morning.

4 HEARING OFFICER LOYER: Would please state and
5 spell your full name for the record.

6 MR. DRYER: My name is Greg Dryer G-r-e-g
7 D-r-y-e-r.

8 (Thereupon Mr. Dryer was sworn by the
9 Hearing Officer to tell the truth and
10 nothing but the truth.)

11 HEARING OFFICER LOYER: Are you testifying today
12 on behalf of an organization?

13 MR. DRYER: Yes, for Saputo Cheese USA.

14 HEARING OFFICER LOYER: Okay. And please state
15 your affiliation for the record.

16 MR. DRYER: I'm the Executive Vice President of
17 Administration for the company.

18 HEARING OFFICER LOYER: Okay. And please
19 identify the process by which your organization finalized
20 the testimony today.

21 MR. DRYER: I drafted the testimony and it was
22 approved by our corporate headquarters.

23 HEARING OFFICER LOYER: Okay, thank you. You may
24 proceed with your testimony.

25 MR. DRYER: Thank you.

1 Ms. Hearing Officer and members of the Hearing
2 Panel. My name is Greg Dryer. I'm Executive Vice
3 President of Administration and Services for Saputo Cheese
4 USA. My responsibilities in that position among other
5 things include milk procurement for all of the company's
6 U.S. manufacturing facilities. I serve on the Board of
7 Directors of the National Cheese Institute, the American
8 Dairy Products Institute, the Dairy Institute of
9 California, and the Wisconsin Cheese Makers Association.
10 And I'm a member of the Institute of Food Technologists,
11 the Wisconsin Dairy 2020 Council, and the American and
12 Wisconsin Institutes of CPA's. I've been employed in the
13 U.S. dairy industry for the past 27 years.

14 Our company, Saputo, has 15 manufacturing
15 facilities across the United States, four of which are
16 located here in California.

17 Three of the four California plants purchase milk
18 for the manufacture of cheese. The fourth plant utilizes
19 cheese from our own plants and that of other companies for
20 further processing and packaging. We employ approximately
21 900 people in the state and purchase a substantial portion
22 of the state's milk production.

23 I'm here to testify in support of the alternative
24 proposal filed by the Dairy Institute of California dated
25 September 24th, 2007. The proposal fundamentally supports

1 the August 14th petitioner's request to eliminate the dry
2 whey factor from the Class 4b formula, updates the
3 allowances for cheese and nonfat dry milk to the most
4 recently available based on the CDFA 2006 manufacturing
5 cost study released on September 18th, 2007, and updates
6 FOB adjusters to reflect the average difference between
7 the California and CME cheddar cheese prices between
8 January 2001 and August 2007.

9 I guess first I'd like to say we are not milk
10 processors. At Saputo, we're cheese makers, not milk
11 processors. We do not exist solely to identify and pursue
12 the highest returning short-term outlet for milk. We
13 exist to satisfy our customers' needs for wholesome high
14 quality dairy products and services at competitive prices.
15 By doing this well, our shareholders are able to realize
16 satisfactory returns on our investments, our employees
17 enjoy the opportunity for long and rewarding careers, and
18 our suppliers benefit from a stable, enduring outlet for
19 their products and services at market prices.

20 This philosophy precludes us from abandoning
21 customers when for one period it becomes more profitable
22 to make cheddar than mozzarella or dry whey rather than
23 whey protein isolate. Therein lies a fundamental problem
24 with regulated prices based on our arbitrary end-product
25 values, yields, and manufacturing costs. Regulated prices

1 are intended to be minimum or market-clearing prices, not
2 vehicles for extracting every conceivable ounce of that
3 potential value from finished products. As customers for
4 their milk, we believe producers should receive as market
5 value based on supply and demand conditions that exist in
6 the region where they operate. They're also entitled to
7 any protections afforded them by government due to the
8 disproportionate risks they face inherent with their
9 business.

10 Producers should not be entitled to prices based
11 on the moment's optimum mix of alternative dairy products.
12 Market-based prices are needed to send the appropriate
13 economic signals to the industry's participants. The
14 current system is failing us by requiring plants to pay
15 more than they can afford for their milk and sending the
16 signal to increase milk production at a time when the
17 local supply is outstripping the capacity to process it.

18 The whey factor. The whey factor has created
19 enormous issues for the cheese industry. The problem is
20 not isolated to California because USDA incorporates a
21 similar factor in their Class 3 formula. To the best of
22 my knowledge, California has never demonstrated the need
23 to wait for USDA to lead the way out of a difficult
24 situation.

25 The magnitude of the problem is evidenced by an

1 increasing number of cheese plant closures and business
2 failures. There appears to be a general misconception
3 that this problem exists only amongst smaller plants. In
4 fact, the trend towards extremely large or mega cheese
5 plants is driven to a great degree by efficiencies gained
6 by onsite whey processing of economic scale.
7 Unfortunately, not all cheese plants are well suited for
8 the mega paradigm. It works well for long-hold or frozen
9 cheeses, but presents logistical problems for short-lived
10 or fresh cheeses. The sheer velocity of product emanating
11 from such plants can create costly problems in the
12 management of inventory with regard to shelf life.
13 Smaller to medium sized facilities are often more
14 conducive to such products.

15 Without the scale to justify the investment in
16 onsite whey processing, or without the ability to achieve
17 the efficiency anticipated in the California manufacturing
18 cost study in the event such investment is made, small and
19 medium sized plants are left with the prospect of selling
20 whey in liquid form or buying whey from other producers in
21 an attempt to achieve that scale. That prospect adds
22 costs well in excess of those encompassed in the
23 California study.

24 A conservative estimate of the cost of moving
25 liquid product in the State of California ranges from 3 to

1 \$4 per loaded mile. To move 6 percent whey 100 miles
2 would typically cost \$400 or approximately 13 cents per
3 pound of whey solids or almost 50 percent on top of the
4 current whey make allowance. Obviously a 200-mile haul
5 would double that cost.

6 There's numerous other inefficiencies associated
7 with aggregating a whey supply in such a manner. Saputo
8 cannot be considered a small company under any reasonable
9 measure. But of Saputo's three California cheese
10 manufacturing facilities, only one has on-site whey drying
11 capability.

12 Whey Permeate. Relatively few cheese companies
13 today dry skim whey. Most fractionate whey in some
14 fashion or other. These processes typically generate a
15 whey protein concentrate stream and a lactose permeate
16 stream. Thirty-four percent whey protein concentrate is
17 the most basic WPC product, with a protein concentration
18 similar to that of nonfat dry milk. In making 34 percent
19 WPC, typically 30 percent of the whey solids end up in the
20 WPC stream and 70 percent in the lactose permeate. As the
21 protein concentration increases from 34 to 50 percent to
22 80 percent or 90 percent, the percentage of lactose
23 permeate increases further. It's difficult for many to
24 justify investment in further processing of the permeate
25 stream because its value historically is often below the

1 cost of production.

2 For example, California dairies, which
3 manufactures a large volume of ultra-filtered milk,
4 generates an even larger volume of high quality milk
5 permeate. This is a similar but higher quality product
6 than whey permeate because it hasn't been exposed to all
7 the processes and ingredients utilized in the cheese
8 operation. Yet CDI chooses to sell these solids as a feed
9 product in liquid form, presumably at little or no profit,
10 rather than to risk investing in an attempt to add further
11 value.

12 The California 4b formula assumes 100 percent of
13 whey solids return at least the dry whey market net of
14 manufacturing allowance. With little or no return on 70
15 percent of the whey solids, this presents a very high
16 hurdle for many plants to achieve.

17 Whether plants can sustain that value over time
18 depends on market conditions and their individual plant
19 structure. Plant structure once established is very
20 difficult to change. Some plants in the state receive no
21 revenue from whey. Many lose money on permeate. If the
22 regulated price remains too high for too long, the demands
23 for milk will eventually diminish due to attrition.

24 If the benefits of innovation and capital
25 investment are arbitrarily transferred away from the risk

1 takers in the milk price formulas, innovation, investment,
2 and risk taking here will ultimately cease.

3 California competitiveness. Since 2004, the
4 California 4b price has averaged about 50 cents per
5 hundredweight below the USDA Class 3 price. It currently
6 costs the equivalent of roughly 90 cents per hundredweight
7 to move milk from California to the Midwest in the form of
8 a truckload of cheddar cheese. Deliveries to the East
9 Coast cost around dollar twenty per hundredweight.
10 California needs to be able to compete with other regions
11 for sales to these large, remote markets.

12 FOB adjuster. We believe that utilizing an FOB
13 price adjuster over the longer period of January 2001
14 through August 2007 will smooth out distortions which
15 result from timing differences evident in the 24-month
16 calculation.

17 Make allowances. According to the CDFA data, the
18 current cheese make allowance covers zero percent of the
19 volume of California cheese plants. Adopting the current
20 weighted average would cover 70 percent of the volume.
21 Even at that level, 30 percent of the state's capacity
22 remains at risk. The state should -- plants remain at
23 risk. The state should adopt the current cost average at
24 a minimum consistent with prior practice.

25 Alternative proposals. Any proposal that

1 increases the 4b price would only aggravate the oversupply
2 conditions that already exist in the state and should not
3 be given serious consideration. Proposals that are
4 inherently discriminatory, complex, or difficult to
5 administer should also be rejected on the merits.

6 The argument to implement a price snubber on the
7 dry whey component of the 4b formula to prevent it from
8 becoming negative should be interpreted as an argument in
9 favor of its complete elimination. Surely, in fairness,
10 no one could argue that a company should take on the
11 multitude of risks inherent with a major investment in
12 whey processing, relinquish most all of its potential for
13 profit, but retain all of its associated downside price
14 risk. Such a request demonstrates a clear desire to
15 distance oneself from any direct financial exposure to
16 whey processing and only serves to support the
17 justification for the whey factor's elimination.

18 And if I could interject there, there's been
19 discussion in previous testimony about the fact that the
20 producer does share the risk. But I would submit that the
21 producer shares price risk; that if the price falls below
22 the make allowance, the factor can go negative; but none
23 of the risk involved with the capital investment, which I
24 heard testimony too of a small whey processing facility
25 costing \$20 million. And they bear none of the risk of

1 the \$20 million that the multitude of things that can
2 happen from an environmental standpoint or even a
3 regulatory standpoint that could make that investment
4 valueless. So if the 4b formula were changed to another
5 alternative product, it could make your plant valueless
6 basically, and the producer doesn't share in that risk.

7 The real solution to the problem facing the
8 cheese industry is the elimination of the whey factor as
9 proposed by the petitioners. Other solutions either make
10 the situation worse or unworkable or don't go far enough
11 to address the critical needs of the industry. In the
12 past, the Secretary's been unwilling to adopt the Panel's
13 recommendations to eliminate the dry whey factor from the
14 4b formula. We hope that the Panel will remain consistent
15 with its previous recommendations, as this action is more
16 urgent than ever. We hope the Secretary will concur. In
17 the event that the Department does not remove the dry whey
18 factor, at a minimum the make allowance for dry whey
19 should be increased to the new weighted average cost of
20 30.99 cents as calculated in the most recent CDFA cost
21 survey.

22 Conclusion. Whether allowed, our free market
23 economy works. Prices that are too low stimulate demand
24 and cause prices to rise. Rising prices encourage
25 production, eventually causing prices to moderate.

1 Success in an intensely regulated system depends on the
2 wisdom of the regulators. Mistakes made in managing the
3 regulated price can seriously damage an industry.
4 Furthermore, signaling a willingness to manipulate
5 regulations to achieve short-term goals can serve as a
6 deterrent to capital investment under that system.

7 California should be consistent and progressive
8 in its regulation. The market should be the primarily
9 determinant of price, and the regulated price should be
10 the minimum or market-clearing price. Dairy farmers
11 should be afforded some protections due to the nature of
12 their business, but not at the expense of processors or
13 cheese makers.

14 Thank you for your attention and the opportunity
15 to testify on behalf of Saputo. And I'll attempt to
16 answer any questions you may have at this time.

17 And I'd also respectfully request the Department
18 grant a period of time to file a post-hearing brief if
19 warranted.

20 HEARING OFFICER LOYER: That request is granted.

21 Does the panel have any questions of this
22 witness?

23 AGRICULTURAL ECONOMIST GOSSARD: On page 6 of
24 your testimony, just above the "Whey Permeate," you say of
25 Saputo's three California cheese manufacturing facilities,

1 only one has on-site whey drying capability.

2 When you say whey drying, are you including dry
3 whey, WPC, any form of dry whey -- dry whey stream?

4 MR. DRYER: Yes, any dry whey derivative product.
5 Two of the plants ship the product in liquid form.

6 AGRICULTURAL ECONOMIST GOSSARD: In condensed
7 form?

8 MR. DRYER: Yes.

9 AGRICULTURAL ECONOMIST GOSSARD: The other, on
10 page 4 that you -- under "The Whey Factor," you mention
11 the problem's not isolated to California because USDA
12 incorporates a similar factor.

13 You have plants outside of the U.S. Do they have
14 a similar problem? Is there whey factor in other places
15 you operate?

16 MR. DRYER: Outside of the U.S.?

17 AGRICULTURAL ECONOMIST GOSSARD: Yes.

18 MR. DRYER: Not to my knowledge. I don't
19 think -- we have plants in Canada, in Argentina, Germany,
20 and Wales, in fact. And I don't think any of those other
21 countries have whey factor in their --

22 AGRICULTURAL ECONOMIST GOSSARD: Thank you very
23 much.

24 HEARING OFFICER LOYER: Are there any further
25 questions?

1 DAIRY MARKETING BRANCH CHIEF IKARI: I just have
2 one question.

3 You indicate in your testimony adopted a current
4 weighted average would cover 70 percent of the volume. If
5 we were to encourage processing capacity at the 4b level
6 for cheese plants, what would we -- what would you
7 recommend that the state set the make allowance? And you
8 may want to consider that and put that in your
9 post-hearing brief.

10 MR. DRYER: I'll certainly do that. But to me
11 the price that we should be discussing -- I think the
12 reason that these hearings become so contentious is we are
13 trying to arrive at the price. We are negotiating a price
14 between producers and processors, the price that they will
15 receive, the price that we pay, and the state is the
16 arbiter. And in estimation, what we should be talking
17 about is a regulated price, which should be the market
18 clearing price -- minimum price; and that price
19 negotiations should take place between buyers and sellers
20 of these products. And they should typically be at levels
21 above the regulated price. And only in conditions where
22 there's an oversupply would we go as low as the regulated
23 price.

24 Instead we're trying to arrive at the price. And
25 therein lies all of these problems in my estimation.

1 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: I
2 have a question.

3 On the 70 percent figure that you have in your
4 testimony, you're suggesting that the Department should be
5 consistent, and I think with prior practice is what you
6 had indicated.

7 Yesterday, Dr. Erba in his testimony for CDI had
8 some comments regarding that practice wherein that if you
9 had a plant that had been considered relatively efficient
10 and a plant that was a higher cost plant dropped out of --
11 or went out of business for some reason, now a plant that
12 one year had been considered efficient is now on the
13 higher cost end and could be considered inefficient.

14 Would you care to comment on that thought process
15 relative to this 70 percent historical using some measure?

16 MR. DRYER: Again, I come back to, if the market
17 is establishing a value -- if I can buy milk and make a
18 profit by buying milk and converting into a product, I
19 will want to buy more milk.

20 If a price is thrust upon me that's beyond a
21 price that I can afford to pay, the fact is -- and it
22 should be happening today -- I shouldn't be buying the
23 milk. The cheese industry of California today if it
24 weren't for contractual obligations or for defending a
25 customer base or capital investment in this state, they

1 wouldn't be buying this milk because it's overpriced. We
2 should allow the market to establish the price instead of
3 trying to identify, you know, the price that ends up being
4 paid, you know, that everybody's forced to pay. If a
5 plant is small, that's in the 30 percent or something, and
6 can't afford the price, then ultimately if they're not
7 competitive what they're offering farmers for the milk,
8 then they don't get milk.

9 But if there's farmers out there that have milk
10 that they need to find a home for and they're willing to
11 sell at that price, it should sell at that price.

12 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE:

13 Thank you.

14 HEARING OFFICER LOYER: Are there any further
15 questions from the panel?

16 Hearing none.

17 Thank you very much, Mr. Dryer, for your
18 testimony.

19 I'm going to now call a short recess. We will go
20 off the record and reconvene at 10:15.

21 (Thereupon a recess was taken.)

22 HEARING OFFICER LOYER: Okay. We're going to go
23 ahead and start. Going back on the record.

24 Excuse me. We're going to go ahead and start the
25 hearing. Going back on the record.

1 And I will be calling the next witness. That is
2 Paula Floriano.

3 Is there a Paula Floriano?

4 Well, not hearing from Ms. Floriano, we're going
5 to skip her. And I will call her next out of order.

6 DAIRY MARKETING BRANCH CHIEF IKARI: Jake
7 DeRaadt?

8 MS. LaMENDOLA: He was unable to come back today.

9 HEARING OFFICER LOYER: Okay. Noting for the
10 record then that Jake DeRaadt was unable to come back
11 today, we'll be moving along.

12 Calling next Baird Rumiano.

13 Good morning, Mr. Rumiano. Do you have any
14 exhibits or items you'd like to submit?

15 MR. RUMIANO: I do not.

16 HEARING OFFICER LOYER: Okay. Thank you.

17 Would you please state and spell your full name
18 for the record.

19 MR. RUMIANO: My first name is Baird B-a-i-r-d,
20 last name Rumiano R-u-m-i-a-n-o.

21 (Thereupon Mr. Rumiano was sworn by the
22 Hearing Officer to tell the truth and
23 nothing but the truth.)

24 HEARING OFFICER LOYER: And are you testifying
25 today on behalf of an organization?

1 MR. RUMIANO: Yes, ma'am.

2 HEARING OFFICER LOYER: Please state the name of
3 that organization and your affiliation, for the record.

4 MR. RUMIANO: Rumiano Cheese Company,
5 Owner/Manager.

6 HEARING OFFICER LOYER: Okay. And please
7 identify the process by which your organization finalized
8 your testimony today.

9 MR. RUMIANO: I'm sorry?

10 HEARING OFFICER LOYER: Yes, sorry.

11 Please identify the process by which your
12 organization finalized your testimony today.

13 MR. RUMIANO: I don't understand the question.

14 HEARING OFFICER LOYER: How did you come to your
15 testimony today? Is it just you or --

16 MR. RUMIANO: Just me. I'm one of the
17 petitioners.

18 HEARING OFFICER LOYER: Okay. Good enough.

19 MR. RUMIANO: Sorry. This is my first rodeo,
20 so --

21 (Laughter.)

22 HEARING OFFICER LOYER: Oh, that's fine. Mine
23 too actually.

24 (Laughter.)

25 HEARING OFFICER LOYER: So that's kind of funny.

1 Well, you may go ahead and proceed with your
2 testimony then.

3 MR. RUMIANO: Okay. My name is Baird Rumiano.
4 I'm Owner/Operator, Rumiano Cheese Company, Crescent City,
5 California. We are a cheese manufacturing business. We
6 buy milk from approximately 36 producers, convert the milk
7 into Monterey Jack, cheddar, and our world famous dry
8 Monterey Jack. We also make some organic cheeses as well.
9 We produce about 10 million pounds a year at our cheese
10 facility in Crescent City, a small town in northwest
11 California.

12 My family has been making fine natural cheese for
13 over 86 years in California. Four generations of
14 Rumiano's have learned the art of cheese making and
15 continue that tradition today.

16 During this time we have endured earthquakes,
17 tsunamis, floods, and power outages that lasted more than
18 a week. Yes we have never been dealt a bigger obstacle
19 than the weight upon pricing of 4b.

20 Rumiano Cheese does not have a whey drying
21 facility or any kind of process to recoup any monies
22 regarding whey. In 1990 we did roller dry whey and found
23 that to be nonprofitable. We found it was easier for us
24 to feed it to animals and apply it to the land.

25 A long time ago when whey was just a byproduct of

1 cheese, it was always a problem. Then someone found it
2 had some kind of worth as a protein concentrate or as a
3 dried product. Cheese factories invested millions of
4 dollars to research and develop an efficient and
5 economical procedure to make a sellable product. Dried
6 whey, whey protein concentrate and lactose and almost
7 every kind of food. Without the cheese maker, these goals
8 would have not been achieved.

9 Rumiano Cheese Company cannot afford to process
10 whey. We are too small and too rural. For example, we
11 are 400 miles north of San Francisco and 350 miles south
12 of Portland, Oregon. A beautiful place to live but far
13 from any processing plants.

14 In the last six months for a short-term fix we
15 have diverted 35 percent of our milk to another processor.
16 This was also at a lot, but a much less loss than we would
17 have incurred if we had processed this into cheese.

18 We find out that our milk is leaving the state at
19 a substantial discount and returning as cheese to compete
20 with Rumiano Cheese and other cheese makers in the state.
21 This is not a fair competition and California cheese
22 makers face an emergency situation.

23 Rumiano Cheese feels that we are already paying
24 for the solids in the 4b formula. Why should we pay for
25 them twice?

1 On behalf of Rumiano Cheese Company, I ask that
2 you -- that the dried whey component be eliminated from 4b
3 pricing.

4 Thank you.

5 HEARING OFFICER LOYER: And, sir, do you plan on
6 submitting a post-hearing brief?

7 MR. RUMIANO: No.

8 HEARING OFFICER LOYER: Okay. Any questions from
9 the panel?

10 MILK POOLING BRANCH CHIEF LEE: Yes, Mr. Rumiano.

11 As you heard, that there -- one of the other
12 petitioners with the Alliance, MPC, Western United have
13 proposed a credit process. What are your feelings on that
14 proposal?

15 MR. RUMIANO: Too little too late. It's not
16 viable. It's not going to work for me.

17 MILK POOLING BRANCH CHIEF LEE: Thank you.

18 MR. RUMIANO: I mean I'm looking at cheese
19 prices -- this particular whey component raised my price
20 by 30 cents a pound on cheese. And I make Monterey Jack
21 and cheddar. I mean I do make some specialty cheeses such
22 as dry Monterey Jack. But in the marketplace, competing
23 with other companies around the United States, it's
24 impossible to raise that extra 30 cents a pound.

25 DAIRY MARKETING BRANCH CHIEF IKARI: Mr. Rumiano,

1 could you clarify what you mean by roller dry whey?

2 MR. RUMIANO: Yes. It's -- they take these large
3 cylinders, usually around 48 inches in diameter, they're
4 heated by steam. First the whey is concentrated to about
5 20 percent solids. The concentrate is then put on to
6 these rollers. They turn counter-clockwise. And through
7 evaporation, the solids are dried and then scraped off
8 with a blade, usually go into a trough. And then from
9 there they usually go into a -- either a bag or they're
10 milled and then go out into a bag. And most of it is used
11 for animal feed.

12 DAIRY MARKETING BRANCH CHIEF IKARI: You
13 indicated over the last six months some of your milk was
14 diverted to another processor. Was that processor a
15 cheese processor?

16 MR. RUMIANO: No. Powder plant.

17 DAIRY MARKETING BRANCH CHIEF IKARI: A powder
18 plant?

19 MR. RUMIANO: Uh-huh.

20 DAIRY MARKETING BRANCH CHIEF IKARI: Oh, in your
21 area?

22 MR. RUMIANO: Yes.

23 DAIRY MARKETING BRANCH CHIEF IKARI: You also
24 indicated that you find out that some of the California
25 milk is being shipped out of state and then sold at a

1 lower price.

2 Can you give us more details on that?

3 MR. RUMIANO: Well, not without perjuring myself
4 probably.

5 It's just that I've heard that milk has left the
6 state, it's being processed in different areas, southwest,
7 Idaho, Utah, it's being converted into cheese and being
8 sold back into California.

9 DAIRY MARKETING BRANCH CHIEF IKARI: Have you
10 gotten from your customers -- or is that price being
11 reflected in the price that the customer is willing to --

12 MR. RUMIANO: I've been offered cheese -- milk
13 for making cheese at a substantial discount before from
14 certain other people in the business.

15 DAIRY MARKETING BRANCH CHIEF IKARI: Within
16 California?

17 MR. RUMIANO: Within California, yes, sir.

18 DAIRY MARKETING BRANCH CHIEF IKARI: California
19 production you've been offered at below minimum prices?

20 MR. RUMIANO: Yes, sir.

21 DAIRY MARKETING BRANCH CHIEF IKARI: Okay. I
22 have no further questions.

23 AGRICULTURAL ECONOMIST GOSSARD: I had a
24 follow-up question to Mr. Ikari's.

25 You said that as part of the roller drier you had

1 a condenser that took the product to 20 percent solids.
2 When the roller drier itself proved uneconomic, did you
3 give any consideration to shipping the condensed whey to
4 another facility?

5 MR. RUMIANO: No. The closest facility's about
6 400 miles away, which makes it, you know, impossible
7 to -- makes the concentrate worth, you know, nothing
8 because of the hauling.

9 AGRICULTURAL ECONOMIST GOSSARD: Thank you very
10 much.

11 MR. RUMIANO: You're welcome.

12 HEARING OFFICER LOYER: Are there any further
13 questions from the panel?

14 Thank you, Mr. Rumiano.

15 MR. RUMIANO: Thank you very much.

16 HEARING OFFICER LOYER: I'm going to once again
17 call Paula Floriano.

18 Okay. Let the record show that I'm going to
19 strike Ms. Floriano from the witness list then.

20 I'm going to call the next witness, which would
21 be Scott Hofferber.

22 MR. HOFFERBER: We're ready to proceed. The
23 point of order though, having already presented, it's my
24 understanding that we have to wait to allow everybody else
25 an opportunity. Is that correct? It's up to you.

1 HEARING OFFICER LOYER: You may go ahead and
2 proceed now.

3 Let the record show that I'm marking Mr.
4 Hofferber's testimony Exhibit 67.

5 (Thereupon the above-referenced document
6 was marked as Exhibit 67.)

7 HEARING OFFICER LOYER: Okay, gentlemen, I just
8 want to take you each in order.

9 Mr. Hofferber, will you please state and spell
10 your name for the record again.

11 MR. HOFFERBER: My names is Scott Hofferber.
12 It's H-o-f-f-e-r-b-e-r. And I'm the Controller at
13 Farmdale Creamery.

14 (Thereupon Mr. Hofferber was sworn by the
15 Hearing Officer to tell the truth and
16 nothing but the truth.)

17 HEARING OFFICER LOYER: Okay. And just again for
18 the record, are you testifying on behalf of an
19 organization?

20 MR. HOFFERBER: Yes, I'm testifying on behalf of
21 the Board of Directors of Farmdale Creamery?

22 HEARING OFFICER LOYER: And how was your
23 testimony finalized?

24 MR. HOFFERBER: We drafted it, reviewed it
25 together, and they approved the presentation.

1 HEARING OFFICER LOYER: Thank you.

2 And, sir, would you also please state and spell
3 your name for the record.

4 MR. SHOTTS: Michael Shotts S-h-o-t-t-s.

5 (Thereupon Mr. Shotts was sworn by the
6 Hearing Officer to tell the truth and
7 nothing but the truth.)

8 HEARING OFFICER LOYER: Thank you.

9 You may proceed with your testimony.

10 MR. HOFFERBER: Good morning, Ms. Hearing Officer
11 and members of the Hearing Panel. I am still Scott
12 Hofferber, the Controller at Farmdale Creamery, Inc., and
13 I am making this presentation at the direction and on the
14 authority of our board of directors. Our board is
15 represented again today by Norm Shotts and Michael Shotts,
16 who were introduced to the Panel during yesterday's
17 proceedings.

18 We are here today to gratefully take advantage of
19 the opportunity to testify to our company's position
20 relating to the matters of this hearing. And that's in
21 deference to presenting the petition that we did
22 yesterday.

23 We must first correct a portion of our testimony
24 from yesterday. Dairy Institute's legal counsel has
25 informed me that particle board is not made from sawdust

1 but rather wood chips.

2 (Laughter.)

3 MR. HOFFERBER: Therefore, we withdraw the
4 related comment about the revenue from sawdust, you know,
5 that was in our testimony from yesterday --

6 (Laughter.)

7 MR. HOFFERBER: -- and we stand corrected on the
8 issue.

9 (Laughter.)

10 MR. HOFFERBER: Regarding the F&A, et al.,
11 petition, we obviously support the F&A, et al., petition.
12 We testified earlier in this hearing as to the removal of
13 the dry whey factor from the 4b formula in the minimum
14 regulated price. The producer community's claim that it
15 is entitled to all of the value in the waste whey stream
16 above some make allowance amount based on a product almost
17 no one makes is completely dismissive of the value-added
18 nature of what whey processing cheese makers do to convert
19 that waste material into something marketable.

20 Referring to Mr. Van Dam's calculation of value
21 of whey, to use the 4b formula itself to assess that value
22 is using the term to define itself. We have already
23 described a more sound valuation method, that of what one
24 could expect to get for the wet whey stream in the state
25 that it's in when it comes off the cheese line. And that

1 value is really virtually nothing, in our opinion.

2 As Mr. Rumiano testified, even in a concentrate
3 form, the transportation of that wet whey stream is not
4 viable to do anything else with it. It's a disposal
5 system.

6 We will have to forever agree to disagree on this
7 point. The whey stream has no value except for the value
8 added by the cheese makers. I will give any taker of my
9 whey stream -- I will give it to any taker my whey stream
10 for free. But I can't find any takers. Isn't that the
11 measure of the value of something, what an arm's length
12 person is willing to exchange for it?

13 However, know that if an equitable solution to
14 the situation cannot be found and quickly, then processing
15 capacity in the state will certainly not grow and very
16 likely shrink in the face of continued milk supply growth.
17 Farmdale has absolutely no incentive to grow and a growing
18 disincentive to even remain a player in the cheese
19 business.

20 The AWMP petition and the AWMP/MPC/WUD
21 alternative proposal. We do to not support this proposal
22 because it misses the point entirely. On one hand these
23 producer groups dismiss the small specialty cheese makers'
24 problem with the whey factor by claiming the resulting
25 additional milk cost can be returned from the marketplace.

1 This is a gross oversimplification which demonstrates the
2 dismissive and naive understanding of the cheese-making
3 business, in our opinion. If it is so simple to get it
4 out of the marketplace, why can't producers just raise
5 their service charges or premiums by two bucks a
6 hundredweight instead of fooling around with the formula.

7 This lack of understanding is probably part of
8 the reason the producers no longer find themselves making
9 cheese in this state. It just isn't as lucrative as they
10 thought. But on other hand, they seek to relieve only the
11 extremely small processor, ostensibly a specialty cheese
12 maker, with their proposed two loads a day relief plan.
13 The incongruity is plain to see.

14 I've got some comments in the margin that I got
15 to get in here at one point.

16 As to the snub whey element, how can we create
17 yet another way to shelter the producer from the downside
18 risk of being in a business? Their own study has told
19 them that the fundamental problem is that they are
20 oversupplying their marketplace with milk. Also,
21 California Dairy Women Association's Linda Lopes reports
22 that the results of a survey they performed that shows
23 producers clearly understand they are oversupplying the
24 market, with only 8 percent of those surveyed favoring
25 doing nothing to mitigate the growth pattern. And that

1 article's attached.

2 Let's deal with that first, the oversupply. Then
3 let's talk about how we can simplify the system further to
4 allow free market mechanics and signals to properly
5 function, instead of talking about how much more
6 complicated we can make an already too complicated raw
7 product pricing system.

8 We are not insensitive to the concerns of the
9 dairy farmer in the last couple years' lower prices. But
10 we cannot be duped into thing that the root problem is
11 anything other than of their own creation, that of the
12 oversupply.

13 Let's see. Oh, and to Mr. Van Dam's and the kind
14 of the ongoing invitation to come to the table to talk
15 about the bigger picture or longer term, because we have a
16 good understanding and a deep abiding interest in the
17 long-term viability of the cheese industry, Farmdale would
18 always come to a table to work the long-term situation
19 out. But without the adoption of the petition, we -- oh,
20 to -- without the adoption of the petition to eliminate
21 the whey factor, we likely won't survive to be at that
22 table.

23 The Dairy Institute of California alternative
24 proposal. We certainly support this alternative. The
25 original petition was admittedly in a hurry in response to

1 the petitioner's collective crisis with the overpriced
2 milk in order to get the ball rolling on the hearing.
3 This alternative proposal incorporates the petition's
4 removal of the whey factor with the appropriate updating
5 of the cost-justified make allowances in accordance with
6 the Department's audits.

7 The lag in implementing make allowances has been
8 significantly detrimental to Farmdale. The make allowance
9 in effect for '05 was based on '03 data, the make
10 allowance for '06 was based on '03 data for ten months,
11 and then '04 data for two months. And now we're
12 three-quarters of the way through '07 and are nearly two
13 years' behind on utilizing adequate make allowances to
14 cover true costs.

15 The underfunding of our implied contractual
16 relationship with the producer community are funds we can
17 never recoup. We have no believe that costs will fall in
18 the future, creating a reverse effect that would average
19 out this inequity. Anyone believing such is naive and
20 without credibility, in our opinion. If make allowance
21 had been updated timely for '05 and '06, we figure our
22 cheese operation might have been near break-even or
23 slightly in the black in those years. Even if those
24 results were in the black, certainly there's still not
25 enough profitability to engender a desire to grow for us.

1 For us to consider growth, the Department must
2 recognize that the true value of the whey stream to the
3 producer is only what someone would pay me for my wet skim
4 whey stream, which is nothing.

5 The Land O'Lakes alternative proposal. Simply
6 updating the make allowances without eliminating the whey
7 factor does not properly correct the formula for the
8 value-added proposition that whey conversion is to cheese
9 makers. This band-aid only serves to defer the correction
10 of the whey factor inclusion error to another day and, as
11 long as the measurement of the value of whey remains above
12 the cost-justified make allowances, the disincentive to
13 continue in the cheese business remains for Farmdale.

14 The Humboldt Creamery alternative proposal. We
15 have similar objections to this as we do the other
16 proposal that discounts a portion of our 4b milk
17 procurement. Although a larger discount, this proposal
18 fails to remedy even our level of procurement adequately
19 to cause us to remain interested in making cheese.
20 Further, it does not update the make allowances to their
21 proper cost-justified values.

22 The California Dairies, Inc., alternative
23 proposal. The idea of creating an incentive for
24 increasing capacity in this way creates complexity in the
25 formula, a burden on the Department to define what

1 qualifies and when it qualifies, and does not get to the
2 heart of the problem, oversupply. If milk supply was
3 properly managed by the producer community, maybe we'd
4 actually have the appropriate amount of capacity right
5 now. We can't know until we remove all the dampening
6 effects to the market signals and let the free market
7 determine the real price and value of milk. That's not
8 going to happen any time soon, but we can today move
9 toward an environment that will allow an opportunity for
10 existing capacity to remain in place for the time being.

11 Let's let the markets determine the price, not
12 regulation. If we did, milk supply could contract, as the
13 study suggests will happen anyway, and the capacity in
14 place might be adequate for true demand; or sufficient
15 incentives will emerge to cause capacity to increase to
16 accommodate the insistent growth in milk supply.

17 In any event, as long as the whey factor remains
18 in the formula at anywhere near the impact that it's had
19 since 2003, the incentive proposed here not entice us to
20 expand our cheese-making capacity.

21 We implore the Department to adopt a position
22 that the wet skim whey stream has no value, as evidenced
23 by the fact that there was no market for it in California.
24 The whey disposal or conversion costs that are the cheese
25 makers' to bear -- let's see. I screwed that sentence up.

1 The whey disposal or conversion costs are the cheese
2 makers' to bear. Therefore, any potential gains to be had
3 are the cheese makers' to keep. The producers should not
4 be sharing in the whey processing outcomes beyond, at
5 best, a very minimal value of the wet whey residue from
6 the basic products, like cheese. Once this concept is
7 embraced, the clarity that follows surrounding the
8 risk/reward nature of the widely varying implementation of
9 whey processing is there for all to see. The bigger the
10 risk, the bigger the investment, the bigger the reward,
11 the bigger the failure - all of which belong on the cheese
12 maker's side of the equation, in our view.

13 Please remember that this hearing was requested
14 on an emergency basis and, while whey price levels have
15 come down, they have only returned to the levels of recent
16 years' concerns and losses for Farmdale. The problem is
17 certainly not solved for us and other smaller cheese
18 makers, 52 of the 60 or so, just because the whey price
19 has receded. We implore the Department to continue this
20 process at their best speed and return a decision in the
21 continuing spirit you have all demonstrated so far in this
22 process.

23 With our request for the opportunity to submit a
24 post-hearing brief, this testimony is respectfully
25 submitted on behalf of the -- well, on behalf of Farmdale

1 Creamery in this case.

2 Thank you.

3 HEARING OFFICER LOYER: Your request is granted.

4 Do you have any further testimony?

5 MR. SHOTTS: No.

6 HEARING OFFICER LOYER: Any questions from the
7 panel?

8 SENIOR AGRICULTURAL ECONOMIST DOEGEY: I have
9 question, please.

10 On page 4 of your testimony under the paragraph
11 where you discuss the California Dairies alternative
12 proposal, you have "the study" in quotations. What study
13 are you referring to?

14 MR. HOFFERBER: McKinsey is what I'm referring to
15 there. I didn't know how to spell it last night, so I --

16 (Laughter.)

17 SENIOR AGRICULTURAL ECONOMIST DOEGEY: So you
18 went with "study," right?

19 (Laughter.)

20 MR. HOFFERBER: I'll let you ask the question.

21 SENIOR AGRICULTURAL ECONOMIST DOEGEY: Thanks for
22 that opportunity. I've been trying to jump in.

23 (Laughter.)

24 MR. HOFFERBER: You bet.

25 (Laughter.)

1 HEARING OFFICER LOYER: Are there any further
2 questions?

3 AGRICULTURAL ECONOMIST GOSSARD: Also on page 4
4 at the bottom of the same paragraph, you say, "as long as
5 the whey factor remains in the formula at anywhere near
6 the impact has had since 2003..."

7 In terms of the impact, the Alliance, et al., had
8 proposed to put a floor on impact of the whey price. Is
9 there some ceiling that could be put on so --

10 MR. HOFFERBER: 26.7 cents.

11 (Laughter.)

12 AGRICULTURAL ECONOMIST GOSSARD: Let me get this
13 straight. If we adopt this concept of capping it at the
14 make allowance and then the Alliance, et al., of flooring
15 it at the make allowance, then it will continue really to
16 give a zero value?

17 MR. HOFFERBER: That's correct.

18 AGRICULTURAL ECONOMIST GOSSARD: Wouldn't it be
19 simpler just to remove the whey factor?

20 MR. HOFFERBER: That is our petition.

21 AGRICULTURAL ECONOMIST GOSSARD: Thank you for
22 that clarification.

23 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: I
24 notice on page 5 of your testimony you indicate that the
25 producers should not be sharing in the whey processing

1 outcome, at best, a very minimal value.

2 So while you're testifying that the whey factor
3 should be eliminated, it also looks or appears that you
4 are indicating that perhaps there should be some value or
5 it wouldn't be unreasonable for some value to approve of
6 the producers?

7 MR. HOFFERBER: Yeah, you have to work on
8 separating opinion and practical experience from our
9 standpoint to the body of evidence that's being thrown out
10 here. And I know that we attached Umhoefer's article to
11 yesterday's testimony, where he indicated something like a
12 10 to 20 cent kind of number. Where I -- you know, from
13 my own view from an economic standpoint, if no one's going
14 to pay me anything for what I've got, which is a -- I
15 guess, you know, at a million pounds a day is a
16 substantial -- you know, it's critical mass apparently, by
17 some people's standards. If I can't get anybody to come
18 and take that for free, then the value would be zero to
19 me. But it appears that nationally, based on the
20 information in that article, there are stand-alone whey
21 plants that are paying something to pull that stuff into
22 their operations and go do something profitable with it.

23 I guess I have to allow for that opportunity.
24 How I'd measure that number in California though is a
25 mystery to me and will have to be determined by somebody

1 else. That's where that comes from. You know, until
2 somebody comes and says, "You know what, we'll pay you
3 something for the wet whey stream," you know -- and we do
4 have experience doing that, by the way. Prior to -- we do
5 the roller drier process that Baird described earlier.

6 And we switched to that in about '98?

7 Oh, no, it was after I showed up in '97, yeah.
8 We turned it on -- well, actually it was about the time I
9 showed up. So we're talking '97-'98 we went to that
10 process from a process of doing a condensing to a
11 liquid -- 20 percent liquid solution like you were
12 discussing.

13 And, again, we were only able pretty much to
14 cover our costs doing that. I think it returned just a
15 tiny little bit out of it, and that's why we looked into
16 going and moving into the roller drier thing, because we
17 thought we could -- by that investment, we'd be able to
18 enhance that a little more. The return -- I don't want to
19 say profit because it's never profitable, but -- well,
20 except in this last craziness of '07.

21 But in moving to the roller drier, then getting
22 away from just condensing and shipping the fluid away, we
23 saw a way to enhance -- minimize the cost of that disposal
24 process. And that's in prior testimony, the whole
25 description of moving to the roller drier process and the

1 impact that had for Farmdale.

2 But since the inclusion of the whey factor, now
3 we're giving all of that back over to the producer side.
4 And it's just flipped the whole thing upside down. And
5 totally this year it's blown up.

6 Does that answer your question, more or less?

7 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: Yes.

8 AGRICULTURAL ECONOMIST GOSSARD: Just out of
9 curiosity, when you were shipping the condensed whey, how
10 long was the haul?

11 MR. HOFFERBER: Any recall?

12 Thirty miles I think was going to Corona.
13 National Protein in Corona was taking it at that time.

14 AGRICULTURAL ECONOMIST GOSSARD: Okay. Thank you
15 very much.

16 HEARING OFFICER LOYER: Are there any further
17 questions from the panel?

18 Hearing none --

19 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: I do
20 have one more.

21 HEARING OFFICER LOYER: Okay.

22 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: I
23 just want to -- I'm not sure I heard your response
24 correctly. You indicated that you had not been able to
25 make a profit except during this craziness in 2007?

1 MR. HOFFERBER: Right. If you remember my
2 testimony from yesterday, I was showing the losses in our
3 cheese line and the net result of processing the whey,
4 which was then being fed back to the cheese line. I think
5 if you refer back to that section of that testimony,
6 you'll see what I'm talking about. Because we had lost
7 whey -- in the whey-side processing, stand-alone, we lost
8 money '05-'06 and made money in '07. But after feeding
9 the made money back over to the cheese side, we were
10 still -- we're still losing money in the cheese side
11 significantly.

12 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE:

13 Okay. I'll look at that.

14 MR. HOFFERBER: Yeah, look at that.

15 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE:

16 Thank you.

17 AGRICULTURAL ECONOMIST GOSSARD: When you say
18 when you fed it back, was that because your yield from the
19 dry whey process was less than the five eight -- the
20 formula?

21 MR. HOFFERBER: That's one of the factors that
22 falls in there. But what I mean feeding it back into the
23 cheese side -- again, our testimony yesterday was that we
24 don't treat whey as a separate product line. We treat it
25 as a disposal system on the cheese. So we do make a

1 calculation of what those processing costs are against the
2 revenue. But whatever that net number is goes back
3 against milk costs, plus or minus, and then gets bled down
4 through our costing model on the cheese side. And those
5 data are in the testimony from yesterday.

6 HEARING OFFICER LOYER: No further questions from
7 the panel?

8 Okay. Hearing none.

9 Thank you, gentlemen.

10 Next I'd like to call Phillip Franco and Charlene
11 Franco.

12 And I'm marking the testimony of Phillip and
13 Charlene Franco as Exhibit 68.

14 (Thereupon the above-referenced document
15 was marked as Exhibit 68.)

16 HEARING OFFICER LOYER: I might as well start
17 with you, Ms. Franco.

18 Please state and spell your name for the record.

19 MS. FRANCO: My name is Charlene Franco
20 C-h-a-r-l-e-n-e F-r-a-n-c-o.

21 (Thereupon Ms. Franco was sworn by the
22 Hearing Officer to tell the truth and
23 nothing but the truth.)

24 HEARING OFFICER LOYER: Are you testifying today
25 on behalf of an organization?

1 MS. FRANCO: Yes, Sierra Cheese Manufacturing
2 Company.

3 HEARING OFFICER LOYER: Please state your
4 affiliation.

5 MS. FRANCO: I'm Vice President and General
6 Manager.

7 HEARING OFFICER LOYER: Okay. And please
8 identify the process by which your organization finalized
9 your testimony today.

10 MS. FRANCO: I drew up the document and the board
11 of directors approved.

12 HEARING OFFICER LOYER: Thank you.

13 And then, sir, would you please also state and
14 spell your name for the record.

15 MR. FRANCO: My name is Phillip Franco
16 P-h-i-l-l-i-p F-r-a-n-c-o.

17 HEARING OFFICER LOYER: And you're testifying on
18 behalf of the same organization?

19 MR. FRANCO: Correct.

20 HEARING OFFICER LOYER: And what is your
21 affiliation with that organization?

22 MR. FRANCO: I am a production supervisor.

23 HEARING OFFICER LOYER: Okay. Are you going to
24 be filing a post-hearing brief?

25 MS. FRANCO: Yes.

1 HEARING OFFICER LOYER: Okay. That request will
2 be granted.

3 And then you may go ahead and proceed with your
4 testimony.

5 MS. FRANCO: Okay. Thank you.

6 My name is Charlene Franco. I'm the Vice
7 President and General Manager of Sierra Cheese
8 Manufacturing Company, Incorporated. I'm here on the
9 authority of Sierra Cheese's Board of Directors to support
10 the F&A Dairy's petition to eliminate the dry whey factor
11 in the 4b milk pricing formula.

12 Sierra Cheese is a family-owned and operated
13 company located in Compton, California, since 1955, with
14 approximately 36 employees. We have made our success over
15 the last 50 years with quality products traditionally
16 made. We support our customers with personal service
17 difficult to find in today's marketplace. We're not a
18 large facility but have a niche market that has become
19 well known in the Italian and now also in the Hispanic
20 community.

21 After manufacturing our cheese, the remaining
22 whey is disposed of down the sewer. We do not dry the
23 whey and cannot financially or geographically consider
24 adding a whey drying operation as has recently been
25 suggested. Continuing to weather these drastic upheavals

1 in pricing due to the dry whey factor and a low cheese
2 make allowance has become increasingly impossible.

3 The dry whey component has increased our milk
4 pricing to the extent that we have entered an emergency
5 status in our operations which consist of decreased
6 production and workforce. The component has drastically
7 changed our milk pricing, so much so that we have suffered
8 a loss of business due to pricing factors and had to put
9 off facility upgrades and expansion plans in order to see
10 what direction this crisis will be taking us. Recovering
11 from this crisis will be a long and arduous task and
12 recouping our losses will never happen.

13 We ask that you please consider the F&A Dairy's
14 petition and vote to eliminate the dry whey factor in the
15 4b milk formula.

16 Thank you.

17 HEARING OFFICER LOYER: Thank you.

18 So do you have any testimony?

19 MR. FRANCO: No, not right now.

20 HEARING OFFICER LOYER: Okay. Are there any
21 questions from the Panel?

22 DAIRY MARKETING BRANCH CHIEF IKARI: I'm sure the
23 Department has records on your company. But for the
24 record, could you -- it sounds like you're making Italian
25 cheeses and Hispanic Cheeses?

1 MS. FRANCO: Right.

2 DAIRY MARKETING BRANCH CHIEF IKARI: If you can't
3 do it here, you might consider in your post-hearing brief,
4 if you can give us some numbers in terms of the financial
5 loss and the impact of the prices.

6 The other question -- you said you decreased
7 production. How much did you decrease production?

8 MR. FRANCO: We can give you those numbers in our
9 post-hearing brief.

10 DAIRY MARKETING BRANCH CHIEF IKARI: Okay. I
11 wondered if you could also talk a little bit about the
12 whey and the manner in which Hispanic cheese and
13 Mozzarella cheese or Italian cheese is marketed and your
14 ability to get a higher price.

15 MS. FRANCO: For our cheese.

16 DAIRY MARKETING BRANCH CHIEF IKARI: The
17 Department has had a lot of complaints recently in terms
18 of sale below cost. It seems like Hispanic cheese
19 possessors have been reluctant to raise their price to
20 offset their higher raw product costs.

21 MS. FRANCO: Well, we found that with some of our
22 customers it's -- you know, as far as competition goes,
23 when all of this began happening, obviously the milk
24 prices became much higher than the block prices. And,
25 therefore, there became a discrepancy and everything

1 turned upside down.

2 Rather than adjusting prices to reflect that, we
3 were stuck in a position -- from my understanding, how it
4 works, we follow the block market and we always have as
5 far as our pricing. In my experience now, the Hispanic
6 market seems to follow a negotiated pricing for the year
7 or whatever the company happens to base their pricing, on
8 whether it's their milk pricing. So there became a
9 problem.

10 DAIRY MARKETING BRANCH CHIEF IKARI: So the
11 buyers are asking for like fixed prices for a long-term
12 period?

13 MS. FRANCO: They have asked us before.

14 DAIRY MARKETING BRANCH CHIEF IKARI: And there's
15 no adjustment when the milk price goes up?

16 MS. FRANCO: No. We've never done that. So I
17 don't know what the other companies are doing.

18 RESEARCH ANALYST II GATES: Excuse me. I just
19 have one question for you.

20 You say you dispose of the whey stream, you know,
21 down the sewer. Is that at a cost to you?

22 MS. FRANCO: It is. We have a -- Los Angeles
23 County Sanitation District, we pay quarterly. And we pay
24 a nominal fee yearly for that, depending on the amount
25 that goes down.

1 RESEARCH ANALYST II GATES: Okay.

2 MS. FRANCO: So we're constantly trying to work
3 on our readings to make that better.

4 RESEARCH ANALYST II GATES: Thank you.

5 AGRICULTURAL ECONOMIST GOSSARD: In your
6 testimony you said that it would not be feasible to add a
7 whey drier.

8 Had you looked at the possibility of putting in a
9 condenser and finding someone to take the condensed whey
10 from you?

11 MS. FRANCO: Have we done that?

12 AGRICULTURAL ECONOMIST GOSSARD: Yes.

13 MS. FRANCO: No, we haven't. We haven't done it.
14 I'm more concerned about some of the upgrades in our
15 facility to make the cheese more profitable for us right
16 now. I mean that's where our focus had been rather than
17 the whey.

18 AGRICULTURAL ECONOMIST GOSSARD: And you said
19 your company's been in existence in 1955 -- since '55.
20 And you've been making cheese all this time?

21 MS. FRANCO: Yes.

22 AGRICULTURAL ECONOMIST GOSSARD: Thank you.

23 No further questions.

24 HEARING OFFICER LOYER: Are there any further
25 questions from the Panel?

1 Thank you both for your testimony.

2 MR. FRANCO: Thank you.

3 HEARING OFFICER LOYER: Next I'd like to call
4 Barbara Martin.

5 Ms. Martin, do you have any exhibits or any items
6 you'd like to submit into evidence?

7 MS. MARTIN: No, I don't.

8 HEARING OFFICER LOYER: Okay. Would you please
9 state and spell your full name for the record.

10 MS. MARTIN: Barbara Martin B-a-r-b-a-r-a Martin
11 M-a-r-t-i-n.

12 (Thereupon Ms. Martin was sworn by the
13 Hearing Officer to tell the truth and
14 nothing but the truth.)

15 HEARING OFFICER LOYER: Are you testifying today
16 on behalf of an organization?

17 MS. MARTIN: Tony Martin Dairy.

18 HEARING OFFICER LOYER: And what is your
19 affiliation with that organization?

20 MS. MARTIN: Owner.

21 HEARING OFFICER LOYER: And please identify the
22 process by which your organization finalized your
23 testimony today.

24 MS. MARTIN: I wrote it on the bus on the way up
25 here today. And it comes from my heart. That's all.

1 HEARING OFFICER LOYER: Thank you.

2 You may proceed with your testimony.

3 MS. MARTIN: As I stated, my name is Barbara
4 Martin. My husband and I own Tony Martin Dairy in
5 Lemoore.

6 I sit before you now and urge you to adopt the
7 proposal of Western United Dairymen and the compromise it
8 offers to all parties. I hope you take in consideration
9 the loss of income dairy farmers will endure if you remove
10 the dry whey component. God knows we've endured enough
11 loss the past couple years.

12 I understand the difficulties that some of the
13 cheese factories have faced. I want nothing more than to
14 find a resolve. I understand completely the struggle of
15 keeping your head above water. I can assure you last year
16 I was drowning. I had no life jacket in sight.

17 My husband and I are both third generation dairy
18 farmers. I have heard the horrors of our parents and what
19 they endured before pooling. I will never forget the
20 wailing and tears of my mother and brother as the cows
21 left their dairy in 1991 because the dairy business became
22 too tough and they made the decision to sell.

23 But today I sit before you. I sit with pride and
24 my head held high knowing that all of our hard work every
25 single day and surviving the struggles that have passed

1 us, I am here providing a great, high quality product.

2 I make milk. Milk that enables high quality
3 cheese and other fine dairy products. Producers and
4 processors are partners. And to say we are not entitled
5 to receive a fair price for our product and that we don't
6 assume any risk is unfair.

7 I'm not naive enough to think that the high price
8 we are receiving can last forever. I know we have
9 capacity issues. I know we have to balance our supply
10 with demand. But removing the dry whey component is not
11 the solution. And the compromise that Western United
12 Dairymen offers is a step towards fair resolve for all of
13 us. All of us just want a fair profit for the products we
14 produce.

15 I thank you for the opportunity to speak. And
16 God bless us all.

17 HEARING OFFICER LOYER: Thank you.

18 Does the Panel have any questions for this
19 witness?

20 Hearing none.

21 Thank you, Ms. Martin.

22 I'd like to note that I'm at my last page of
23 witnesses. So if anyone has neglected to sign up, they
24 may wish to do so now.

25 And I'm going to call Sue Taylor.

1 I've marked Ms. Taylor's testimony as Exhibit 69.

2 (Thereupon the above-referenced document
3 was marked as Exhibit 69.)

4 HEARING OFFICER LOYER: Ms. Taylor, can you
5 please state and spell your name for the record.

6 MS. TAYLOR: My name is Sue Taylor T-a-y-l-o-r.

7 (Thereupon Ms. Taylor was sworn by the
8 Hearing Officer to tell the truth and
9 nothing but the truth.)

10 HEARING OFFICER LOYER: And are you testifying
11 today on behalf of an organization?

12 MS. TAYLOR: I am. It's Leprino Foods Company.

13 HEARING OFFICER LOYER: Okay. And what is your
14 affiliation with that organization?

15 MS. TAYLOR: I'm Vice President of Dairy Policy
16 and Procurement and I have the lead responsibility for
17 formulating the company's dairy policy positions.

18 HEARING OFFICER LOYER: Okay. And can you
19 identify the process by which your organization finalized
20 your testimony today.

21 MS. TAYLOR: I developed the testimony, and it
22 was reviewed by other senior executives and approved.

23 HEARING OFFICER LOYER: Thank you, ma'am. You
24 may proceed with your testimony.

25 MS. TAYLOR: I'm Sue Taylor, Vice President of

1 Dairy Policy and Procurement for Leprino Foods Company.
2 Leprino operates nine mozzarella plants in the United
3 States. Three of these are located in California, two in
4 Lemoore and one in Tracy.

5 I'm testifying today in support of the Dairy
6 Institute of California's alternative proposal for the
7 Class 4b formula. I fully support Dr. Bill Schiek's
8 testimony presented at this hearing.

9 I'm also testifying today in opposition to the
10 joint Class 4b formula proposal put forth by the Alliance
11 of Western Milk Producers, Western United Dairymen, and
12 Milk Producers Council; and the Class 4a and 4b proposals
13 put forth by Humboldt Creamery. Additionally, I'm
14 testifying in opposition to the pool credit proposals put
15 forth by the Alliance, et al., and California Dairies.

16 State of the cheese industry. The cheese
17 industry is under stress that has been manifested in
18 California by consolidation, producer payment defaults,
19 and reductions in plant throughput over the last year.
20 Although some have characterized this stress as being a
21 small cheese maker issue, it clearly is not. Several
22 large cheese plants with whey processing capacity have
23 also experienced significant challenges. Land O'Lakes was
24 very public about the financial difficulties at their CPI
25 plant in Tulare and subsequently sold that plant.

1 Dairy Farmers of America was similarly quite
2 clear that their Corona plant has been a financial drain.
3 Their August 8th press release, attached as Attachment A
4 to this testimony, announcing the reduction in throughput
5 August 31st and planned closure January 1st, indicated
6 that, quote, "Market conditions and operating results have
7 hindered success at our corona plant and in our American
8 Cheese Division. We constantly look for ways to end
9 losses and stimulate profitability," unquote.

10 In a conversation that I had the prior day with a
11 senior executive of DFA, I was told that the September 1
12 reduction was designed to reduce the plant throughput to a
13 level at which the processing of their whey stream into
14 any products other than sweet whey could be eliminated,
15 thereby eliminating the losses on the other more
16 specialized whey products produced at the plant. Although
17 I am not privy to the magnitude of the losses on these
18 other specialized whey products, one can assume that they
19 had to be very significant to have justified the increased
20 plant overhead costs per pound production that will be
21 associated with the reduced throughput.

22 Additionally, several of the petitioners have
23 testified at this hearing that they curtailed cheese
24 production due to the poor whey economics. I suspect
25 additional cheese plants have done the same. Three cheese

1 plants have struggled to fulfill producer payment
2 obligations and have been placed on the ineligible list
3 for the Producer Security Trust Fund within the last 60
4 days. All of these changes are reflective of the stress
5 that has been created because the Class 4b price generates
6 a milk price that exceeds the revenue stream of the
7 finished products being produced by many of state's cheese
8 makers.

9 The current scenario whereby the Class 4b price
10 formula extracts greater revenue than is generated by the
11 cheese makers for the finished products is contrary to
12 sound policy and the principles underlying minimum milk
13 pricing. Relief is critical in order for the cheese
14 industry to regain its health.

15 The whey factor. The F&A, et al., petition and
16 Dairy Institute's alternative proposal call for the
17 elimination of the whey factor. This is the single
18 correct policy choice given the lack of inherent value in
19 dilute whey, the extraordinarily high capital cost of whey
20 processing that creates a barrier to entry, and the lack
21 of convergence in returns amongst the diversity of whey
22 products produced in California.

23 Dilute whey from a cheese vat has no value in the
24 marketplace. Skim whey prior to condensing is typically
25 6.1 to 6.5 percent solids. At this low level of

1 concentration, transportation costs quickly consume the
2 historic market value above costs of processing. I'm not
3 aware of any dilute whey that is being sold within
4 California. Since raw, dilute whey has no marketplace
5 value, the value derived from the finished whey products
6 is attributable to the further processing that is
7 performed by the whey manufacturer.

8 My understanding is that the current whey cost
9 studies that serve as a reference point for the setting of
10 the Class 4b make allowances include costs associated with
11 in-plant whey processing. In other words, they do not
12 reflect the cost of moving whey between plants for further
13 processing because none of the participating whey plants
14 consolidate whey from multiple cheese plants. Therefore,
15 if a market for dilute whey does develop at some time, the
16 cheese maker surely would not be able to recover the whey
17 value assumed in the Class 4b formula. The cheese maker
18 would likely be faced with paying the transportation costs
19 or would receive a price discounted by transportation at
20 best. In either case, the cheese maker selling the whey
21 would still be suffering a loss due to overvaluation of
22 whey in the regulated pricing system.

23 High capital costs. Whey processing is highly
24 capital intensive. Leprino has invested well over \$100
25 million in the whey processing machinery and equipment at

1 our California plants. This is well below what it would
2 cost today for the same systems because of the rapid rise
3 in construction material costs, particularly stainless
4 steel. But the current milk pricing system only allows
5 for a meager return on investment due to the declining
6 asset value methodology used to calculate the ROI factor
7 in the cost study.

8 The extraordinarily high whey capital costs
9 create a barrier to entry for small cheese plants. This
10 lack of processing capacity amongst some small plants was
11 a concern at the time that whey was explicitly added to
12 the Class 4b formula, but I grossly underestimated the
13 magnitude of the potential impact and I suspect nearly
14 everyone in the industry did the same. At the time, whey
15 prices had fallen within a relatively narrow range a
16 little above or below the cost of processing. As such,
17 the impact on milk prices was small enough that specialty
18 cheese makers were able to extract the value out of their
19 cheese revenue stream. However, the run-up in whey prices
20 over the last year resulted in months when whey prices
21 enhanced the minimum regulated price by more than \$3 per
22 hundredweight, setting an insurmountable hurdle for cheese
23 makers without whey process -- no, without whey capacity
24 to overcome.

25 Returns disconnect. Sweet whey was historically

1 viewed as the lowest common denominator amongst all whey
2 products. This was because it is the most generic whey
3 product requiring the least advanced technology, and
4 returns were generally lower than those for the more
5 highly refined whey proteins. It was thought that so long
6 as the milk price was based upon sweet whey prices, the
7 whey contribution to the milk price would not be
8 overstated.

9 This long-held assumption is no longer true. As
10 more processors invested in whey fractionation technology,
11 the increased production of whey protein concentrates
12 depressed those prices. Simultaneously, as older plants
13 producing sweet whey were mothballed, the supply and
14 demand balance pushed sweet whey prices up. Consequently,
15 the portion of the milk price attributable to the sweet
16 whey value has outstripped the returns from the
17 WPC/lactose complex numerous months over the last year.

18 Our returns above, operating and a reasonable
19 return on investment on the WPC-80/lactose complex, fell
20 short of recovering the milk costs assumed in the Class 4b
21 formula in our 2006 and year-to-date 2007, which is ten
22 months at this point, fiscal years.

23 The same was the case for our WPC-35/lactose
24 combination in FY '06 and many months in FY '07. This
25 inability to recover our milk costs exists even though we

1 process our lactose stream. Many cheese makers do not
2 process their lactose stream, so had even greater losses
3 than we experienced during that period.

4 Although I generally believe markets equilibrate
5 over time if the returns from one product outstrip the
6 returns of another, there are several reasons to expect
7 that the whey market will not equilibrate as quickly and
8 gracefully as other markets.

9 Specifically, number 1, whey products fill
10 different market niches that are driven by different
11 demand factors. Although WPC and lactose can be
12 substituted for sweet whey in some applications, most
13 applications are looking for the specific attributes of
14 either WPC or lactose. High protein WPCs are typically
15 competing with other sources of protein, such as soy, that
16 are disconnected from the overall dairy supply and demand
17 situation.

18 Number 2, few plants can justify investing the
19 substantial capital required to enable them to shift
20 production amongst the various whey products on a
21 short-term basis. Many plants cannot even flip between
22 WPC-35 and WPC-80 production since WPC-35 production
23 requires an evaporator, which WPC-80 production does not.
24 Furthermore, WPC-80 production requires significantly
25 greater filtration capacity than does WPC-35.

1 Although new plant investments will be made in
2 the highest return product, this capacity adjustment
3 occurs over years rather than over weeks or months.
4 Without meaningful flex capacity, the net returns across
5 the whey complex can be expected to remain disconnected.

6 Number 3, substantial volumes of whey products
7 are exported and are, therefore, subject to many
8 additional supply and demand factors unrelated to domestic
9 supply and demand conditions.

10 Because of the diversity of demand for the
11 various whey products and the relatively fixed production
12 assets, the product prices move independently of each
13 other. This contrasts sharply with the cheese side of
14 complex in which virtually all commodity cheese produced
15 in the United States is priced relative to a common price
16 series and many plants can flex their throughput amongst
17 several varieties of cheese.

18 Returns on commodity cheese converge; returns on
19 whey do not. Therefore, cheddar prices serve as an
20 effective surrogate in the milk price formulas regardless
21 of whether a cheese maker is producing mozzarella or
22 another commodity cheese. No whey products can fill that
23 same role.

24 Diversity of whey production. CFDA's summary of
25 whey products produced in California clearly illustrate

1 the challenge of identifying a whey product representative
2 of statewide production. While helpful data, it does
3 revealed the full complexity of whey production within the
4 State of California.

5 Leprino Foods processes its whey protein stream
6 into WPC-35 and WPC-80 and some specialized proteins
7 within the State of California. As part of this
8 production, lactose is produced in delactose permeate is
9 generated. In California, we produce 39 WPC product codes
10 an 34 lactose product codes. Many of these products have
11 been developed by our R & D staff to address specific
12 applications requiring such attributes as high gelling
13 properties or high heat stability applications for retort
14 applications.

15 Our production of generic WPC-35 or WPC-80 is
16 only a portion of the volume that CDFA would have
17 categorized as WPC-35 and WPC-80 and will likely diminish
18 over time as we expand into these more specialized
19 markets.

20 The bottom line is that there is not a common
21 whey product within California and the nature of supply
22 and demand in the various whey markets, both domestically
23 and abroad, make it nearly impossible to identify a whey
24 product that will accurately reflect market clearing
25 returns generated by the whey complex on an ongoing basis.

1 Summary. The whey factor has contributed to
2 significant financial stress amongst cheese makers
3 evidenced by industry consolidation, plant closures, and
4 plant throughput reductions. Not all cheese makers
5 process their whey, and the lack of convergence amongst
6 whey product returns has resulted in losses amongst
7 manufacturers with even the most sophisticated whey
8 fractionation technology. Raw whey has no inherent value
9 in a marketplace. Based upon these factors, the
10 Department should adopt the F&A, et al., proposal to
11 eliminate the whey factor from the Class 4b formula.

12 Make allowances. The use of the incremental
13 approach (nonfat dry milk plus energy and equipment cost
14 differences to produce whey), as advocated by Western
15 United, et al., to establish the whey make allowance is a
16 far less desirable approach than using an accurate cost
17 study of whey processing costs and should be rejected.

18 The studies that were used to establish the
19 roughly 3 cent higher cost point of reference for whey
20 relative to nonfat production were limited to the energy
21 and equipment cost differences between the products. Both
22 the Venkat and Burleson studies included exclusive
23 statements that management and other costs were also
24 higher for whey production, but they did not attempt to
25 analyze those categories.

1 The Venkat and Burleson analysis was also based
2 upon two plants of comparable throughput. However, there
3 is a significant mismatch of plant capacity between the
4 average California nonfat dry milk plant included in the
5 cost study and the average cheese plant. This difference
6 is compounded by the fact that roughly a third of the SNF
7 taken in as raw milk is captured in the cheese and not
8 available in the whey stream in a cheese plant.
9 Therefore, a cheese plant of comparable milk intake with a
10 butter/nonfat dry milk operation does not have comparable
11 drying scale as the nonfat dry milk plant. Because of
12 these scale differences, the base data for nonfat dry milk
13 costs would significantly understate the costs of
14 processing whey.

15 Proponents of the incremental approach to
16 establishing a whey make allowance suggest that the CDFA
17 whey costs are inconsistent with the Cornell cost study
18 results presented at the Federal Order Class 3 hearings.

19 A quick review of the more detailed Cornell study
20 presented in the September 2006 hearing shows that this is
21 not the case. Table 2, which is Attachment B to my
22 testimony, from the Cornell study is attached and shows
23 that the six high cost plants average 30.07 cents and
24 produced just over 29 million pounds whey per year.

25 The CDFA cost study released in December of last

1 year covering roughly the same cost period showed an
2 average cost of 2851, with average production of just over
3 32 million pounds whey per year. The other six plants
4 that averaged over 65 million pounds whey per year drive
5 down the overall average on the Cornell study
6 significantly.

7 These plants are significantly larger than the
8 national norm, and many of the operations received
9 condensed whey from multiple sources. Dr. Stephenson
10 acknowledged in cross-examination that the cost of
11 condensing the whey at the original plant and
12 transportation costs, if not borne by the receiving plant,
13 were not captured in his cost study.

14 CDFA has completed whey cost studies four
15 consecutive years using their proven and rigorous
16 methodology. The results of these cost studies are very
17 close. Discarding CDFA's own cost studies in order to
18 utilize an estimation method with the noted deficiencies
19 would be wholly inconsistent with CDFA practices and would
20 be poor policy.

21 Price Snubbers. The Western United, et al.,
22 proposal includes a snubber that does not allow whey
23 prices that fall below the manufacturing cost to reduce
24 the Class 4b price. The very existence of a snubber in an
25 end-product price formula is contrary to the primary

1 objective of an end-product price formula. That is, the
2 snubber by definition precludes the formula result from
3 reflecting the market values of finished products at those
4 times when market values fall below the make allowance.

5 The snubber forces manufacturers to absorb losses
6 during low price periods without allowing those same
7 manufacturers to retain revenue that can be used to offset
8 the losses when the market value exceeds the manufacturing
9 costs. The revenues are passed to producers in the form
10 of higher milk prices. The losses should be recovered
11 from those who are holding those beneficial revenues,
12 namely, the producers through the milk price.

13 Plant capacity. The continued growth of milk
14 production in California is well documented. This milk
15 production growth will necessitate additional plant
16 capacity in California.

17 In her testimony at this hearing, the witness for
18 Western United Dairymen inferred that I misled the hearing
19 panel in industry during the June 2006 hearing regarding
20 the construction project at our newer Lemoore plant in
21 June 2006. I take great exception to that inference and
22 want the record to be clear.

23 As noted in my June 2006 testimony, the project
24 that was underway at the time of the June 2006 hearing was
25 a project to increase our line flexibility and did not

1 result in expanded milk throughput capacity.

2 Our decision to build our newest facility in
3 Lemoore was made in 1999, prior to the chilling effects of
4 the April 2003 Class 4b decision. We constructed much of
5 the infrastructure to facilitate cost-effective expansion
6 of milk throughput. This investment and the scale
7 efficiencies that are gained as a result of expanding an
8 existing facility should make a decision to expand the
9 Lemoore West facility an easy one. However, at the time
10 of the 2006 hearing, we had not determined whether to
11 expand at Lemoore West primarily because we had
12 significant concerns regarding the milk price formula that
13 existed at that time.

14 Subsequent to the Department granting the 42 cent
15 per hundredweight relief as a result of the June 2006
16 hearing, we decided to expand the Lemoore West plant.
17 This project is independent of the project started in
18 2006. As such, we secured permit approvals for the
19 expansion within the last 45 days. Although the new plant
20 capacity at the Lemoore plant will allow it to handle an
21 additional 4 million pounds at that location, technology
22 adoption at our other California plants will result in
23 reductions in milk throughput at those plants. Therefore,
24 the net increase in Leprino's milk intake in California
25 will be somewhat less than 4 million pounds per day. This

1 additional capacity will not be commissioned until
2 mid-2009.

3 I would like to once again emphasize that a very
4 significant factor in our decision to expand Lemoore is
5 the fact that we built much of the infrastructure to
6 facilitate the expansion at the time of the original
7 construction, before the onerous milk price formula
8 changes of 2003.

9 Leprino is currently in the process of once again
10 identifying the location for additional plant capacity. I
11 can tell you unequivocally that we are not considering any
12 California locations for the next plant.

13 Discriminatory pricing within classes. Both
14 Western United, et al., and Humboldt have put forth
15 proposals for consideration that would result in different
16 levels of effective California -- or effective class
17 prices for competing cheese makers depending upon size.
18 These proposals create regulatory inequities in an effort
19 to mask economic forces and should be rejected.

20 Regulatory structures should encourage milk to be
21 produced and processed where it is most efficient to do
22 so. It is particularly important to reject the regressive
23 approach embodied in the Western United, et al., and the
24 Humboldt proposals in the context of the increasing impact
25 of international markets on the U.S. dairy industry.

1 International market demand and trade policy reforms have
2 created real opportunities to expand demand for U.S. dairy
3 products. We cannot fully exploit that opportunity and
4 may become vulnerable to further reductions in import
5 barriers if we adopt regressive policies designed to
6 stifle market forces that scale efficiencies otherwise
7 bring to bear.

8 I'd like to note that I do see that I've run out
9 of time. And I am interested in completing, but I would
10 be willing to step back and let the next witness go if
11 that's the preferred approach.

12 HEARING OFFICER LOYER: How much time would you
13 need?

14 MS. TAYLOR: I'm on the second to the last page.
15 So I'm betting five minutes.

16 HEARING OFFICER LOYER: Why don't you go ahead
17 and finish up your testimony

18 MS. TAYLOR: Okay. Thank you.

19 Similarly, CDI's plant expansion incentive
20 proposal should be rejected. We agree that significant
21 costs are incurred as plants are built and commissioned.
22 However, the CDI proposal does not address the underlying
23 economic problems being created by a Class 4b price that
24 is set too high. A three-year credit is interesting, but
25 would not induce us to expand capacity in the context of

1 longer-term structural problems with the finished
2 product/milk price relationship. The significant capital
3 required to build a cheese plant requires that it be a
4 viable economic proposition for decades, not three years.

5 Ultimately, none of these proposals that
6 effectively discriminate class prices based upon size or
7 the addition of a plant capacity do anything to address
8 the underlying problems with the Class 4b formula that
9 must be addressed for all cheese makers.

10 Other conceptual observations. The use of
11 end-product price formulas to establish regulated milk
12 prices requires great caution. A formula that establishes
13 too high a price relative to the finished product values
14 forces processing capacity out of the sector while
15 concurrently encouraging greater milk production. This is
16 precisely today's scenario.

17 Some producer groups have cautioned that granting
18 price relief to processors will generate catastrophic
19 results in the producer sector. These groups have lost
20 sight that marketplace responses to supply and demand
21 factors are how producers garner a revenue stream that
22 sustains their economic viability. It is these
23 supply-and-demand forces that have moved the 4b price in a
24 \$12.34 range, from \$8.84 to \$21.18, and 4a prices in a
25 \$11.90 range, from \$9.31 to \$21.21, over the last five

1 years.

2 The assertion that the granting of 4b price
3 relief will lead to certain disaster is contradicted by
4 recent experience. The 42-cent reduction in 4b prices
5 implemented last November did not translate into a
6 catastrophe for producers. In fact, many producers have
7 acknowledged that they are having a very good year.

8 Squeezing processors by 20 or 40 cents per
9 hundredweight through inappropriate formula factors is not
10 what will keep the producer sector healthy. But setting
11 the milk price above finished product values will, and has
12 caused the manufacturing sector to be unhealthy. And that
13 lack of health has been manifested in lack of investment
14 in plant capacity to process the milk that supply and
15 demand signals are asking to be produced. It also has
16 been manifested in the default on producer payments by
17 several cheese makers.

18 Ultimately, it is in the best interests of the
19 producer sector to have a vibrant and competitive
20 processing and manufacturing sector that develops
21 innovative products that consumers like and creates a
22 greater demand for their raw milk. Setting regulated
23 prices too high diminish the interest and ability of
24 processors to make such investments and results in
25 foregone demand, benefiting neither producer nor

1 processor.

2 In conclusion. The Department's decision from
3 this hearing will determine whether sufficient plant
4 capacity is maintained and additional capacity is
5 developed to handle the increase in California milk
6 supply. The F&A, et al., proposal to eliminate dry whey
7 from the price formula is the only way to retain currently
8 stressed capacity. In addition to the elimination of the
9 whey factor, Dairy Institute's alternative proposal
10 updates the make allowances to the more recent data. This
11 update is necessary and appropriate in order to maintain
12 relevance between the formulas and current costs. The
13 Institute's f.o.b. Adjuster appropriately uses a longer
14 period to determine the f.o.b. adjuster for cheese to
15 isolate out the distortions that occur due to the pricing
16 lags in volatile market periods. The Department should
17 adopt the Dairy Institute's proposal.

18 This concludes my written testimony. I'd
19 appreciate the opportunity to provide input to the
20 Department on these very important issues, and
21 respectfully request the opportunity to file a
22 post-hearing brief.

23 HEARING OFFICER LOYER: Your request is granted.

24 Thank you, Ms. Taylor.

25 Does the panel have any questions?

1 Hearing none -- oh.

2 AGRICULTURAL ECONOMIST GOSSARD: In the second
3 page of your testimony, you mentioned that the -- I'll
4 refer to it as the Cornell study, that you attached, that
5 they did not include the cost of moving whey between
6 plants. Is that a common practice in California? Does
7 Leprino receive condensed whey from other cheese plants?

8 MS. TAYLOR: I do not believe that it's a common
9 practice in California. But it certainly would impact the
10 results of the Cornell cost study. Those costs are
11 grossly understated, to the extent that they have plants
12 that are much larger than otherwise they would be. And
13 the costs that are included in that cost study are not
14 comprehensive. They don't include the cost of condensing
15 the originating plant or the cost of essentially gaining
16 those economies of scale by aggregating that volume, the
17 transportation costs.

18 AGRICULTURAL ECONOMIST GOSSARD: We had an
19 earlier witness yesterday testify that you need to be
20 processing a little over a million pounds of milk a day to
21 make a drier feasible.

22 Given that you have an outlet for the condensed
23 whey, how large a plant do you need to make a condensed
24 whey operation -- a condenser profitable?

25 MS. TAYLOR: I don't know.

1 AGRICULTURAL ECONOMIST GOSSARD: You say at the
2 bottom of page 3 just before your point one, "there are
3 several reasons to expect that the whey markets will not
4 equilibrate as quickly and gracefully as other markets."

5 In his testimony and some questionings, Mr. Van
6 Dam indicated that based on the protein price in whey --
7 dry whey, WPC-34 and nonfat dry milk have equilibrated.
8 Do you disagree with his analysis, or do you see something
9 in the future happening?

10 MS. TAYLOR: I disagree with his analysis. I was
11 not here for his testimony, but I would definitely
12 disagree with that conclusion.

13 AGRICULTURAL ECONOMIST GOSSARD: Okay. And so
14 you think there's still a large disconnect?

15 MS. TAYLOR: I do.

16 AGRICULTURAL ECONOMIST GOSSARD: The Cornell
17 study that you cited, when were the costs -- what was the
18 period for which the costs were collected in that study?

19 MS. TAYLOR: I would have to go back and consult
20 the hearing record. My recollection is that the original
21 study that was put forth in September 2006 included costs
22 from a period that started for some plants in 2004 and
23 went through 2005. And there may have been some months
24 for some plants covered in 2006. It was over a very
25 extended period. For each plant it was only a 12-month

1 period. But there was a variety of time periods across
2 the sample plants.

3 AGRICULTURAL ECONOMIST GOSSARD: Thank you very
4 much.

5 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: You
6 indicate that Leprino is looking to build another plant
7 and that you are not considering California?

8 MS. TAYLOR: Yes.

9 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: Is
10 that consideration based entirely on the prices here in
11 California or is it also based on your customer base and
12 where your future growth in your customer base might be?

13 MS. TAYLOR: There are a variety of issues that
14 eliminated California from even the preliminary search for
15 sites. The pricing -- or the regulatory pricing system in
16 combination with the balance of the regulatory environment
17 here in terms of environment or all the other additional
18 costs that we incur out here, that was a very important
19 element but it wasn't the only element.

20 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE:
21 Thank you.

22 AGRICULTURAL ECONOMIST GOSSARD: I have one
23 additional question, I'm sorry, I forgot to ask.

24 On your first page, you state under the state of
25 the California cheese industry, "The cheese industry is

1 under stress that has been manifested in California."

2 There's a whey factor in the federal Class 3
3 formula. Has this sort of stress been manifested in
4 federal orders?

5 MS. TAYLOR: It has been in some areas. There
6 are some other areas where it's been dealt with through
7 essentially paying below class. If you're a non-pool
8 plant under the federal order system, you are not subject
9 to minimum regulated pricing. The economics, the
10 competition in some regions of the Federal Order force you
11 to pay at or above minimum regulated pricing in order to
12 secure milk supply. But you are not mandated to pay the
13 minimum price. And there are many parts of the country
14 where in fact, particularly due to this whey problem,
15 there have been deals struck to essentially give away
16 credit on a negotiated basis.

17 AGRICULTURAL ECONOMIST GOSSARD: Thank you.

18 HEARING OFFICER LOYER: Do we have any --

19 DAIRY MARKETING BRANCH CHIEF IKARI: I just have
20 one question.

21 CDI in its testimony addressed the percent volume
22 covered. And they suggested the Department get off of
23 criteria where we base it on a certain volume. I'd like
24 to get your input. I don't think we've asked cheese
25 processors their concept, not only on volume, but the

1 equity in setting the make allowance between cheese and
2 butter and powder.

3 MS. TAYLOR: I do believe that it's important to
4 give similar treatment to both complexes. I think it's
5 important for the regulatory structure not to bias toward
6 the processor of one complex versus the other. So if
7 you're targeting 80 percent coverage in one complex, I
8 think it should be roughly the same in the other. And I
9 recognize that because of the magnitude of some of these
10 plants, that you're not going to necessarily hit precisely
11 the same number on both sides. But I think you do have to
12 be careful and be equitable in your treatment.

13 The target -- I've always thought in the realm of
14 70 to 80 percent coverage. I think it's very important to
15 cover a significant portion of volume in order to retain
16 viable outlets for milk in California. But I'm not
17 bothered by leaving some volume uncovered to continue to
18 drive efficiency.

19 DAIRY MARKETING BRANCH CHIEF IKARI: One other
20 question.

21 If the Department went to 90 percent, would that
22 encourage plant expansion?

23 MS. TAYLOR: Yes. You know, any additional wedge
24 between the finished product prices and raw milk prices
25 will improve the outlook of potential manufacturers

1 relative to siting in California.

2 DAIRY MARKETING BRANCH CHIEF IKARI: So the
3 greater the percentage above the 70 to 80 percent, the
4 more we think -- more success we might have in plant
5 expansion?

6 MS. TAYLOR: I believe so.

7 DAIRY MARKETING BRANCH CHIEF IKARI: Thank you.

8 HEARING OFFICER LOYER: Are there any further
9 questions from the panel?

10 Okay. We're going to go off the record here for
11 about five minutes or so.

12 (Thereupon a recess was taken.)

13 HEARING OFFICER LOYER: Back on the record.

14 I'd like call on Ray Souza please.

15 Mr. Souza, can you please state and spell your
16 full name for the record.

17 MR. SOUZA: My name's Ray Souza R-a-y S-o-u-z-a.

18 (Thereupon Mr. Souza was sworn by the
19 Hearing Officer to tell the truth and
20 nothing but the truth.)

21 HEARING OFFICER LOYER: Are you testifying today
22 on behalf of an organization?

23 MR. SOUZA: I will be testifying as an individual
24 today.

25 HEARING OFFICER LOYER: Okay. And you may go

1 ahead and proceed with your testimony then.

2 MR. SOUZA: I mentioned a minute ago I'd be
3 testifying as an individual. But I think it's appropriate
4 that I also mention that I'm the President of the Board of
5 Directors of Western United Dairymen.

6 HEARING OFFICER LOYER: Thank you.

7 MR. SOUZA: I'll keep my comments brief and I'll
8 limit them to the joint alternative petition, more
9 specifically, the elimination of the whey factor in the
10 formula.

11 I believe that the whey -- that the joint
12 petition directly addresses the concerns of the
13 petitioners. But I also want to remind the panel that
14 producers are also in a competitive climate. We're
15 currently recovering from one of the worst -- from the
16 worst record losses we've incurred in modern history.

17 Although we're beginning to see the market
18 recover and beginning to see our prices come back, but
19 that a large part of that is being taken up by increased
20 expenses. Your own cost production records will indicate
21 that we see record prices but we also see record expenses.
22 In fact, our margins are currently -- as the numbers come
23 forward, we're seeing that our margins are getting
24 narrower and narrower.

25 We will also soon face extremely costly

1 environmental regulations as put forth by the Regional
2 Water Board in the Central Valley. These costs could
3 reach a number of which is 60 to \$70,000 in the first year
4 per farm.

5 The demands for producers continue, they continue
6 to mount on all dairies, both large and small. And with
7 that in mind, the petition alternative before you is
8 supported by as large a coalition of dairy farmers as I've
9 seen since I've been in the dairy business and involved in
10 policy.

11 Producers are sensitive to the needs of our
12 processors, and it is their concerns that have motivated
13 producers to provide the credits for powder back to the
14 processors at a level that the issues -- that addresses
15 the issues that the petitioners have brought forward.
16 It's done in a way that we can address our issues without
17 decimating the producer side.

18 Our system is built on commodity pricing, and
19 whey powder is a basic commodity. We believe other dairy
20 producers nationally share that belief with us. In fact,
21 in the U.S. system, in the Federal Order system, whey
22 powder is pooled. In every other Federal Order system
23 it's pooled. It should be the same way in California. In
24 fact, one advantage that we have -- that processors have
25 in California, that the make allowance on whey powder is

1 25 percent higher than it is in any other Federal Order
2 system -- any other system in the United States.

3 Today we see an unprecedented demand for U.S.
4 dairy products. Our industry should be working to
5 capitalize on that opportunity rather than shrink the
6 producer size -- the producer size which are in
7 California.

8 The challenge to expand plant capacity is far too
9 comprehensive to address through a simple action as
10 presented in the petition today.

11 In fact, the current regulatory climate indicates
12 that even if the whey value was effectively depooled, it
13 would require as much as through six years to get any new
14 plant on line. So it basically has no effect on getting
15 any new plants within the next six years.

16 Plant capacity is a concern for all of us. But
17 the problem is far too complicated than simply reducing
18 powder price. A more appropriate forum than this group
19 today is to encourage an industry gathering working
20 together to find all possible solutions.

21 Thank you.

22 HEARING OFFICER LOYER: Thank you.

23 Does the Panel have any questions for this
24 witness?

25 DAIRY MARKETING BRANCH CHIEF IKARI: Mr. Souza, I

1 asked Mr. Van Dam: If the Department is to take a
2 leadership position in trying to bring the industry
3 together -- and perhaps you can think about it and file it
4 in a post-hearing brief -- how can it be structured so
5 everybody comes and works for a fair pricing formula that
6 has a success -- I mean a chance for success for the long
7 term, where we're not in a hearing every other -- from one
8 side or another, from one hearing to the next, where one
9 group feels like they've been slighted?

10 MR. SOUZA: Well, thanks for bringing that up,
11 because I believe, again, this hearing today, which was
12 really the core hearing, the petition, was to deal with
13 how do we have -- how do smaller cheese plants deal with
14 the ability of turning their whey stream into a powder,
15 the cost of doing that, which is far too great for some of
16 the smaller plants? That's why we've come up with an
17 alternative proposal, was trying to address that
18 unilaterally. It's with all groups.

19 I mean we -- I think, Mr. Ikari, you can see that
20 this is probably one of the few times that producers have
21 voluntarily come forward and said, "Look, we understand
22 the problem. We're willing to work with you." And we're
23 simply willing to take a price cut, which is what we're
24 doing here. We've offered that up to the processors to do
25 that, to help them with their problems, because we

1 understand the importance of processing.

2 Now, you're asking how this could be resolved. I
3 think there's a couple of ways. Those discussions are
4 taking place -- or beginning to take place now. The
5 problem is unilaterally understood. And that's the very,
6 very beginning. I think there's some individuals that
7 have talked about setting up some meetings and there seems
8 to be a growing interest in that.

9 You've talked about -- you mentioned doing it
10 through the Department here. That's also possible. We
11 recently had that blue ribbon committee. That panel did a
12 wonderful job of going through some of the issues with the
13 pool quota. I think it could be set up very similar to
14 that. I think it has to be a representative group. And I
15 think it has to be beyond just agriculture. The problem
16 that we're having with manufacturing in California is not
17 just cheese plants.

18 We have a regulatory system in California that's
19 making it very difficult for any type of manufacturing
20 plant to expand. We see -- the numbers are indicating now
21 that we're seeing plants leave California, in fact,
22 honestly, even the United States. This is a bigger
23 problem than just reducing the raw product cost.

24 Probably -- you know, I think it could be done
25 through possibly a CDFA blue ribbon panel, again,

1 including economists, bankers, people far beyond just the
2 typical agricultural community.

3 Does that answer your question? I gave a 10
4 dollar answer for a 5 cent question, I know.

5 (Laughter.)

6 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: I
7 have a couple questions.

8 First, you compare in California a system to
9 Federal Order systems and point out that whey is a factor
10 in some of the Federal Order systems.

11 Aren't there some differences as pointed out by
12 the testimony for Leprino regarding plants being able to
13 depool in the Federal Order? And doesn't that change the
14 dynamics a bit from what plants could do here in
15 California?

16 MR. SOUZA: Well, plants can depool in the
17 Federal Order. There's no question about that. But
18 plants can also depool in California. The primary
19 difference is a California plant when it chooses to become
20 nonregulated, it's committed to that nonregulation for a
21 year. Where unfortunately in the federal system, plants
22 can jump in and out of the pool, effectively pool riding.

23 That's one of the problems that we see in the
24 Federal Order. Even folks that within the Federal Order
25 see a serious problem with the Federal Order system. And

1 I think that we have a much superior system in California.

2 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE:

3 Well, what I was making reference to was in a
4 Federal Order when a plant depools and it becomes
5 deregulated, they have no minimum price obligation;
6 whereas, here in California, even if a plant were to
7 depool, they are still obligated to the producers at the
8 announced 4b price. So they don't get around the minimum
9 Class 4b price, but they don't -- they aren't obligated to
10 the pool.

11 MR. SOUZA: We have a system in California we
12 think is superior. And the inferiorities of the federal
13 problem should be fixed by the feds.

14 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: And
15 you indicated in your answer to Mr. Ikari that you
16 recognize that there is an issue and that you're willing
17 to take a price cut. Yet the Department's analysis shows
18 that your proposal would actually be a price increase and
19 put more monies into the pool.

20 MR. SOUZA: I think you're taking it beyond my
21 comments. When I was commenting, I was talking just
22 strictly to the issue of keeping the whey factor in the
23 pool. And it does take -- when you eliminate a hundred
24 thousand pounds per plant, it does take milk out of the
25 pool and it would have an effect.

1 Now, what you're talking about is taking the next
2 step further, which would be the make allowance cut or
3 reducing the make allowance. That would effectively put
4 more money back into the pool again, offset some of that,
5 that's true.

6 MILK POOLING RESEARCH MANAGER SHIPPELHOUTE: All
7 right. That's it.

8 HEARING OFFICER LOYER: Are there any further
9 questions from the Panel?

10 DAIRY MARKETING BRANCH CHIEF IKARI: Well, at the
11 risk of another \$10 answer --

12 (Laughter.)

13 DAIRY MARKETING BRANCH CHIEF IKARI: Let me be
14 more specific.

15 If the Department makes a decision to adopt the
16 F&A proposal and eliminates whey, what incentive is there
17 for them to come to the table? And if the Department
18 accepts the Alliance/Western United/MPC proposal, what
19 incentive is there for the producers to come to the table?

20 MR. SOUZA: There's always an incentive, because
21 we recognize that there's a problem with plant expansion.
22 We just don't believe that this hearing should be
23 addressing plant expansion. Expansion should be taking
24 place out of that -- that issue is far too complicated.
25 It should we taken out of this hearing.

1 DAIRY MARKETING BRANCH CHIEF IKARI: But that's
2 the question, Ray. The question is: If we're going to
3 develop a long-term solution, how can we structure it so
4 where all the parties have an earnest interest to come and
5 nobody is on the high ground saying, "Well, jeez, you
6 know, the Department" -- Mr. Van Dam said, "Well, the
7 Department's" -- or "the Panel's recommendation to
8 eliminate whey puts the producers on the low ground"?

9 Similarly, whatever decision we make, if you
10 adopt one or the other, somebody's going to be on a high
11 ground, somebody's going to be on a low ground. And I'm
12 asking you to consider in -- provide in a post-hearing
13 brief how can we structure that so that everybody is on
14 equal ground.

15 MR. SOUZA: Well, that's not something I was
16 prepared to develop for the Panel -- for you.

17 DAIRY MARKETING BRANCH CHIEF IKARI: I
18 understand.

19 MR. SOUZA: And possibly during the post-hearing
20 brief we'll have a few minutes and we can come back with
21 some ideas. But I can tell you this, Mr. Ikari, that
22 those discussions are taking place, and it's very
23 heartening to see that they are taking place. Through
24 adversity sometimes we get compromise.

25 But, you know, you're talking about who can have

1 the high ground with the low ground. I think if there's a
2 change to the current system, you're changing and it was
3 on the high ground and the low ground again.

4 So I think the more appropriate thing is to deal
5 with the concerns of the petitioners -- and I underline
6 "petitioners" -- and get back to this plant capacity in a
7 different way. And we'll come back to you with a
8 post-hearing brief with some suggestions.

9 HEARING OFFICER LOYER: Okay. Are there any
10 further questions from the panel?

11 MR. SOUZA: Thank you.

12 HEARING OFFICER LOYER: Thank you, Mr. Souza.

13 Next I'd like to call Linda Lopez.

14 Ms. Lopez, would you please state and spell your
15 full name for the record.

16 MS. LOPES: It's Linda Lopes L-o-p-e-s.

17 HEARING OFFICER LOYER: Oh, I'm sorry. Thank
18 you.

19 And would you go ahead and spell that for the
20 record.

21 MS. LOPES: L-o-p-e-s.

22 HEARING OFFICER LOYER: You did do that. Thank
23 you.

24 (Thereupon Ms. Lopes was sworn by the
25 Hearing Officer to tell the truth and

1 nothing but the truth.)

2 HEARING OFFICER LOYER: Are you testifying today
3 on half of an organization?

4 MS. LOPES: Yes, the California Dairywomen's
5 Association.

6 HEARING OFFICER LOYER: And please state your
7 affiliation.

8 MS. LOPES: I am President of the California
9 Dairywomen.

10 HEARING OFFICER LOYER: Okay. And please
11 identify the process by which your organization finalized
12 your testimony today.

13 MS. LOPES: By meeting and lying awake at night
14 worrying about another fall in the milk price, a repeat of
15 2006.

16 HEARING OFFICER LOYER: Okay. Thank you.

17 You may proceed with your testimony.

18 MS. LOPES: Madam Chair and members. I am Linda
19 Lopes, a dairy producer from Turlock, California, and I am
20 also President of the California Dairywomen Association.
21 I am here to speak in support of the alternative proposal
22 by Western United Dairymen, the Alliance and milk
23 Producers Council. We are in opposition to the proposal
24 by F&A.

25 California producers cannot withstand a reduction

1 in price at this time. Dairymen are still in recovery
2 mode from 2006 milk prices. There is a lot of holes to
3 fill after those 18 months of devastating low milk prices.

4 At this time, we are experiencing record high
5 milk prices. But we are also experiencing record high
6 feed prices: Two-hundred-dollar-plus hay price;
7 three-hundred-dollar cotton seed; thirty-eight-dollar corn
8 silage; along with a high for all grains.

9 We are also facing environmental costs. The
10 floor price was removed. Now the whey value. What's
11 next?

12 Producers are not invisible. We are not pigs at
13 the trough.

14 I leave this in your very capable hands and I
15 thank you for your time.

16 HEARING OFFICER LOYER: Thank you, Ms. Lopes.

17 Are there any questions from the Panel?

18 Hearing none.

19 Thank you, ma'am.

20 MS. LOPES: Thank you.

21 HEARING OFFICER LOYER: Okay. At this time I'd
22 like to call on Joe Mendoza.

23 MR. MENDOZA: Yes ma'am. I'm standing as tall as
24 I can.

25 (Laughter.)

1 MR. MENDOZA: Good afternoon. I'm a dairyman
2 from the Petaluma area. I know Mr. -- some of you don't
3 know me. But Mr. Ikari and I have matched wits and
4 opinions before.

5 HEARING OFFICER LOYER: Well, before you get
6 started, let me -- just a couple procedural things.

7 I do need you to state and spell your name for
8 the record. And I need to swear you in.

9 MR. MENDOZA: Joe Mendoza, Jr. J-o-e
10 M-e-n-d-o-z-a, Jr.

11 (Thereupon Mr. Mendoza was sworn by the
12 Hearing Officer to tell the truth and
13 nothing but the truth.)

14 HEARING OFFICER LOYER: Okay. And are you
15 testifying today on behalf of an organization?

16 MR. MENDOZA: No, as an individual.

17 HEARING OFFICER LOYER: Okay. Thank you.

18 You may proceed with your testimony.

19 MR. MENDOZA: Well, I'm a third generation
20 dairyman from the Petaluma area, and I've been at this a
21 long time. And I really, as Mrs. Lopes stated previously,
22 had some sleepless nights the last five years. And we've
23 gone up and down, and a lot more down than up. And we're
24 just starting to -- we haven't got holes. The only thing
25 I'm going to disagree with Linda about is she said we had

1 holes. We got caves to fill. And we are very concerned
2 about taking a hit of this nature.

3 And I want to state that I believe the Western
4 United/Milk Producers Council solution is the right way to
5 start out.

6 And, believe me, I've been a member of
7 cooperatives all my life. My father and family used to be
8 in Challenge. Then we went to Cal Gold. And now we're
9 with CDI. So we're concerned. We understand the
10 processor end because we're -- we belong to cooperatives.
11 And we worry about whether our cooperatives are going to
12 remain healthy.

13 I'm not so naive that I don't worry about where
14 our milk is going to get processed, because we're very
15 concerned about that.

16 But I really think that the Federal Order system,
17 they have the same kind of pooling for the whey as we do
18 in the system here. Now, the statement was made that,
19 "Oh, the Federal Orders, they can depool," and that's all
20 true. That's very true. In fact, that's one of the
21 problems with the Federal Order.

22 We got a dairyman from the Petaluma area that
23 moved up into northern California here, sold his pool
24 quota, went up bought a ranch in Yreka, shipped into
25 southern Oregon. And, well now, I think it was two or

1 three years ago when our 4b price went up, they -- that
2 area depooled, and they didn't receive a fair price for
3 their milk. So now they just went in the last buyout. So
4 that isn't a way to go either, we don't think. Because I
5 mean people -- you criticize our system. I think we've
6 had a pretty damn good system. Now, it does need to be
7 tweaked here and there. But I think that you have to
8 proceed with caution and not make drastic changes like
9 this -- the Institute's proposal would really put a
10 tremendous burden on the producer. And it sounds kind of
11 silly because there's a lot of milk around.

12 But, believe me, if our milk prices drop -- and
13 we got all these environmental regulations we got with
14 the -- our president has this ethanol thing and our energy
15 costs are going up, which affects the plants too. All
16 this stuff coming down the pike. You got -- they're
17 talking about this Social Security card deal. You know,
18 we got enough problems already without another one
19 reducing our income when we have been under tremendous
20 stress.

21 And Dave's known me a long time. I'm not crying
22 every five minutes. I'm telling you that we got problems,
23 and I sincerely mean that. And I hope that -- I really
24 like Ray's idea of a blue ribbon committee to -- because
25 if these processors have problems, maybe you have to raise

1 the 4b make allowance. I don't know.

2 At least that way you have a chance to really
3 look at the costs and evaluate the thing and go more
4 slowly and look at it in a more systematic approach than
5 just, bango, hit us over the head with a hammer and kill
6 us like this -- it wouldn't kill us, but it sure as hell
7 would damage us badly.

8 Thank you very much.

9 You got any questions, I'll try to answer them.

10 HEARING OFFICER LOYER: Does the panel have any
11 questions?

12 DAIRY MARKETING BRANCH CHIEF IKARI: Just one
13 question.

14 Joe, you realize that if the Department adjusts
15 the make allowance and leaves the whey factor alone, you
16 could still have the net same result in terms of the
17 impact of the pricing formulas.

18 Ultimately what's going to happen is the market
19 signals whether or not supply and demand are in balance.
20 And if they stay in balance, you'll still have high prices
21 whatever the Department does. On the other hand, if you
22 have excess production, regardless of what we do to the
23 formula, the prices will fall.

24 MR. MENDOZA: Well, the reason that the prices
25 went up lately, for an example, was the weak dollar and

1 the demand from India and China -- companies like that
2 wanting better food and all that. I didn't dream that was
3 going to happen. Thank God it did. But the Department or
4 the dairymen or the cheese maker can't take credit for
5 that. It was just an act of God or whatever. I'm sure
6 glad it came along.

7 But we -- I don't think that -- I still think
8 that you'd better be careful when you fix something that's
9 working, because sometimes you fix something over here and
10 you cause another problem over there. I really believe
11 that we should proceed slower, more cautiously. That's
12 why I like the old system of, if the costs are there and
13 they're justified, you know, it will -- the system that
14 you have with the make in California will address those
15 problems in a more fair, orderly fashion.

16 That's the way I look at it, Dave.

17 DAIRY MARKETING BRANCH CHIEF IKARI: Thank you.

18 HEARING OFFICER LOYER: Are there any further
19 questions from the Panel?

20 Hearing none.

21 Thank you, Mr. Mendoza.

22 MR. MENDOZA: Thank you.

23 HEARING OFFICER LOYER: Next I'd like to call
24 on -- excuse me if I'm mispronouncing this -- Rien
25 Doornenbal.

1 Hello.

2 MR. DOORNENBAL: Hello. You did a fine job
3 pronouncing my name, by the way.

4 HEARING OFFICER LOYER: Oh, great. I got it
5 right. Good.

6 Would you please state and spell your name for
7 the record, please, sir.

8 MR. DOORNENBAL: Okay. My name is Rien
9 Doornenbal, spelled R-i-e-n, last name
10 D-o-o-r-n-e-n-b-a-l.

11 (Thereupon Mr. Doornenbal was sworn by the
12 Hearing Officer to tell the truth and
13 nothing but the truth.)

14 HEARING OFFICER LOYER: And are you testifying
15 today on behalf of an organization?

16 MR. DOORNENBAL: No, I'm testifying today on
17 behalf of myself and our own dairy operation, which
18 includes my wife.

19 I should state that I am on the Board of
20 Directors of Western United Dairymen. But I am -- I want
21 to stress I'm speaking for myself.

22 HEARING OFFICER LOYER: Okay. Thank you, sir.
23 And you may proceed with your testimony.

24 MR. DOORNENBAL: Thank you.

25 I'm speaking in favor of the Western United and

1 Alliance and Milk Producers Council's alternative
2 proposal.

3 Our dairy is near Eskalon in San Joaquin County
4 and I'm an average dairymen. Therefore, I believe I can
5 speak for many of my fellow dairymen in the state.

6 The reason I call myself an average dairymen is
7 because I look at our milk production or heard statistics,
8 and they're very similar to most of the other dairies in
9 the State of California.

10 We work with a well known and probably the
11 largest specialized dairy accounting firm, Genske &
12 Mulder. My guess is that most of the Genske & Mulder
13 clients are a little larger and a little more efficient
14 than the average California dairyman. Genske & Mulder
15 clients in California lost in 2006 an average of \$155 a
16 cow. My personal loss was slightly higher than this.

17 By June of this year some of us had recouped that
18 loss. So essentially the full year of 2006 and the first
19 six or seven months of this year was break-even at best
20 for even the most efficient producers of the state.

21 I have a habit of looking in the Hoard's Dairyman
22 for the mailbox prices received by dairy farmers in
23 California as well as Federal Order mailbox prices. It is
24 no secret that California dairy farmers generally receive
25 lower prices than states in Federal Orders.

1 I also check the Dairy Profit weekly newsletter.
2 As we all know, our 4b price is usually substantially
3 lower than the Federal Order Class 3 price. By removing
4 the dry whey factor from the 4b price, obviously that gap
5 would widen by a huge amount. The impact of the widening
6 gap between 4b and Class 3 would put California dairy
7 farmers at a severe economic disadvantage to those
8 producing milk in our neighboring states.

9 I also take issue with the idea that we have a
10 surplus of milk in the state. Plant capacity is tight.

11 And this plant capacity is tight for various
12 reasons. Very little milk as a percentage of the total
13 production has been dumped however. We must recognize
14 that nationwide all of the dairy products produced are
15 being marketed. Dairy products are certainly not being
16 warehoused by private enterprise, much less by the federal
17 government. One cannot deny the fact that we are
18 nationally in an environment of tremendous demand for
19 manufactured dairy products.

20 That concludes my comments.

21 HEARING OFFICER LOYER: Thank you, sir.

22 Are there any questions from the Panel?

23 DAIRY MARKETING BRANCH CHIEF IKARI: I have one
24 question.

25 Can you confirm or deny, as milk leaving the

1 state, can it be processed in the state?

2 Or maybe I should say, isn't being processed in
3 the state.

4 MR. DOORNENBAL: I'm not directly involved with
5 the day-to-day operations of the co-op that I belong to.
6 So I cannot answer that definitively. I have heard that
7 there has been some milk leaving the state, and I don't
8 know how much. But as Mr. Van Dam testified, there is
9 also milk coming into the state. And I don't personally
10 consider the fact that some milk could be leaving the
11 state as a huge problem. I think that problem will be
12 taken care of by some increased plant capacity that's
13 coming on.

14 I think we also have to recognize the fact that
15 we had this past year weather that was very, very
16 conducive to milk production. I think even we had
17 received some testimony. Mr. Jeter even mentioned that
18 they had expected at this time to be receiving less milk.
19 But their own producers -- their direct ships, he called
20 them, were shipping more milk. And a lot of that has to
21 do with the fact that we had some very, very favorable
22 milk producing weather all summer.

23 And also I think that the producers as a response
24 to last year's very, very difficult times, now that they
25 are seeing a chance to recoup some profit, are handling

1 their -- managing their dairies in a way that they can
2 maximize production just because they've got to try to get
3 back to ground zero.

4 DAIRY MARKETING BRANCH CHIEF IKARI: Let me ask
5 the question in a different way. You're not worried and
6 perhaps you don't think the Department should be worried
7 that -- if some of the plant capacity closes or diminishes
8 despite production increases, you're not worried about
9 that?

10 MR. DOORNENBAL: I'm not as -- I personally don't
11 feel that the Department needs to be as concerned about
12 that issue as what the Department seems to be. I
13 belong -- actually belong -- the co-op that I belong to is
14 going to be having some discussions whether or not to put
15 some limits on milk or the milk that we can produce. I've
16 heard talk of that. And we may have to -- we may have to
17 deal with that. But I think that the individual producers
18 and the individual co-ops are more responsible for dealing
19 with plant capacity than what the Department is. And
20 that's just my personal opinion.

21 DAIRY MARKETING BRANCH CHIEF IKARI: Okay. Thank
22 you.

23 HEARING OFFICER LOYER: Does the panel have any
24 further questions?

25 Okay. Hearing none.

1 Thank you, Mr. Doornenbal.

2 And are there any other witnesses listed in the
3 back?

4 No? Okay.

5 In that case, this will conclude this hearing. I
6 would like to remind you that post-hearing briefs will be
7 due by 4 p.m. on Wednesday, October 17th.

8 This hearing is now closed at, it looks like, 12
9 noon on October 11th, 2007.

10 And we are off the record.

11 (Thereupon the Department of Food and
12 Agriculture Market Milk Hearing adjourned
13 at 12:00 p.m.)

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1 CERTIFICATE OF REPORTER

2 I, JAMES F. PETERS, a Certified Shorthand
3 Reporter of the State of California, and Registered
4 Professional Reporter, do hereby certify:

5 That I am a disinterested person herein; that the
6 foregoing Department of Food and Agriculture, Dairy
7 Marketing Branch hearing was reported in shorthand by me,
8 James F. Peters, a Certified Shorthand Reporter of the
9 State of California, and thereafter transcribed into
10 typewriting.

11 I further certify that I am not of counsel or
12 attorney for any of the parties to said hearing nor in any
13 way interested in the outcome of said hearing.

14 IN WITNESS WHEREOF, I have hereunto set my hand
15 this 17th day of October, 2007.

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22 JAMES F. PETERS, CSR, RPR

23 Certified Shorthand Reporter

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